1.1. Introduction

Financial Economics is an important and necessary factor for banking development in India. Though finance is by no means a substitute for real resources, it has a crucial role in the economic development of the country. The funding strategies and profit maximisation is playing a vital role in the growth of banking sectors in India (Thiyagarajan. G. and Arulraj. A. 2012). The segment of capital and money market dealing with lending and borrowing of funds, essentially for short term purposes, is represented by commercial banking institutions. Commercial banks act as financial intermediaries, i.e. intermediaries of saving and investment. Savings intermediations are a process by which flow of savings of the community is allocated to finance investment in the economy. The banking system which constitutes the core of the financial sector plays a critical role in transmitting monetary policy impulses to the entire economic system.

The existence of the Non-Banking Financial Institutions can be traced from pre-independence period but they were functioning in the unorganized sector. It was only in the late fifties, the Non-Banking Financial Institutions were promoted in the organized sector. Although the Non-Banking Financial Institutions (NBFIs) in India have survived for a long time but
they shot into prominence only in the late 1980s (Ingres 2005). In the sixties, the reach of institutional financial intermediaries was quite limited. The magnitude of deposits with banks and NBFIs was of a small order to the tune of Rs.2, 494.80 Crores and Rs. 54.9 Crores respectively as on 31.3.1966. In spite of operating for quite a long time in India, an attempt to regulate them started only in the sixties.

Financial system helps to increase the output by moving the economic system towards the existing production frontiers, by transforming the given total amount of wealth into productive forms. The ultimate goal of the financial system is to accelerate the rate of economic development. The role of the financial system is to channelize funds from surplus units to deficit units. The supply of funds depends upon aggregate savings and credit creation by the banking system, while need of funds depends upon demand for investment, consumer durables, housing and so on. The main function of financial system is to establish a bridge between savers and investors and thereby to encourage saving and investment. Thus a financial system helps to increase the volume of investment. It becomes possible for the deficit spending units to undertake more investment because it would enable them to command more capital.
1.2. Non-Banking Financial Institutions (NBFIs)

NBFIs are financial intermediaries engaged primarily in the business of accepting deposits, delivering credit. NBFIs supplement the role of banking sector in meeting the increasing financial needs of the corporate sector, delivering credit to the unorganized sectors to small local borrowers.

The Non-Banking Financial Institutions (NBFIs) have been playing a very significant role in the present day rigorous money market conditions. They are serving the nation by supporting the economic reconstruction and giving a booster to industrial production. They are engaged into the business of providing loans and advances of small amounts for a short period to small borrowers. The NBFIs play an important role in channelizing these savings into investments. NBFIs supplement the role of banking sector in meeting the increasing financial needs of the corporate sector, delivering credit to the unorganized sector and to small local borrowers. While functioning as financial intermediaries between the savers and the users, they have catered to the different segments of the society.

NBFIs have made great strides in recent years and are meeting the diverse financial needs of the economy. They have greatly influenced the direction of savings and investments. Thus, from the macroeconomic perspective and the structure of the Indian system, the role of NBFIs has become increasingly important. Non-Banking financial institutions (NBFIs) are fast
emerging as an important segment of Indian financial system. It is an heterogeneous group of institution (other than commercial and co-operative banks) performing financial intermediation in a variety of ways, like accepting deposits, making loans and advances, leasing, hire purchase, etc. They raise funds from the public, directly or indirectly, and lend them to ultimate spenders. They advance loans to the various wholesale and retail traders, small scale industries and self employed persons. Thus, they have broadened and diversified the range of products and services offered by a financial sector. Gradually, they are being recognized as complementary to the banking sector due to their customer oriented services, simplified procedures, and attractive rates of returns on deposits, flexibility and timeliness in meeting the credit needs of specified sectors. The directions apply to a NBFI which is defined to include only non-banking institution, which is any hire-purchase finance, loan or mutual benefit financial company and an equipment leasing company but excludes an insurance company/stock exchange/stock broking company /merchant banking company. The RBI (Amendment) Act, 1997 defines NBFI’S as an Institution or company whose principal business is to accept deposits under any scheme of arrangement or in any other manner, and to lend in any manner. As a result of this new definition, a number of loan and investment Companies registered under the Companies Act by Business houses for the purpose of making investments in group of companies are now included as
NBFIs. The Financial intermediaries in Indian Financial System are broadly characterized by Public owned, Monopoly or Oligopoly or Monopolistic market structure and are centralized. The Indian financial system has another part which comprises a large number of private owned, decentralized, and relatively small sized financial intermediaries and which makes a more or less competitive market. Some of them are fund based, and are called (NBFIs) and some are provide financial services (NBFIs) is (1) Loan companies (LCs) (2) Investment companies or ICs (3) Hire-Purchase finance companies or HPFCs (4) Lease finance companies or LFCs (5) Housing finance companies (or) HFCs (6) Mutual Benefit financial companies or MBFCs (7) Residual non-banking companies or RNBCs (8) Merchant Banks (9) Venture capital funds (10) Factors (11) Credit Rating Agencies (12) Depositories and custodial services.

1.3. Classification of Non-Banking Finance Institutions

Classification of NBFIs as given in the Reserve Bank Amendment Act 1997, 1) Equipment leasing company (ELC): Carrying on as its Principal Business, the activity of leasing of equipment. 2) Hire Purchase finance company (HPFC): Carrying hire purchase transactions (or) financing of such transactions. 3) Housing finance company (HFC). 4) Investment Company (IC): Carrying the business of acquisition of securities. 5) Loan Company (LC): Financing by making loans and advances. (Does not include ELC, HPFC, HFC).6) Mutual Benefit companies (MBFC). 7) Residual non-
banking company (RNBC): Company which receives any deposit under any scheme of arrangement, in one lump sum or in instalments by way of contributions or subscriptions or by sale of units or certificates or other instruments or in any other form according to definition of NBFI. 8) Miscellaneous non-banking companies (MNBC): Managing, conducting or supervising as a promoter foreman or agent of any transaction or arrangement. Ex: conducting any other form of Chit and Kuri which is different from type of business mentioned above. After the above classification the Non Banking Financial Institutions were reclassified twice, during 1998 it was classified as four types they were 1) Equipment leasing, 2) Hire Purchase, 3) Investment Company and 4) Loan Companies. During 2006 the NBFIs were reclassified as three types they are 1) Asset Finance companies (in this both Equipment Leasing and Hire Purchase companies were merged), 2) Investment Companies and 3) Loan Companies Apart from those classifications, in order to operate these NBFIs smoothly certain regulations/directions were issued they are a) Regulations for deposits for NBFIs accepting deposits, b) Regulations for NBFIs not accepting deposits and c) Regulations for core investment companies to smooth functioning of their businesses as well as to give confidence to the participants as well as operators. In a very broad sense, NBFIs would include even financial institutions like insurance companies, Life insurance Corporation of India, Unit Trust of India, Industrial Credit and Investment
Corporation of India Ltd., Industrial Finance Corporation of India and Industrial Reconstruction Corporation of India Ltd., as also State Financial Corporations. But for the purpose of our present study, the scope of the term is confined to the types of financial companies enumerated in clause (p) of paragraph 2 (1) of the Non-Banking Financial Institutions (Reserve Bank ) Directions, 1966, which mobilize savings of the community by way of deposits or otherwise and utilize them for the purpose of lending or investment. Thus the NBFIs that we shall discuss here are hire-purchase finance, housing finance, investment, loan, miscellaneous financial or mutual benefit financial companies but excluding insurance, stock exchange or stock broking companies. Non-banking financial institutions (NBFIs) encompass an extremely heterogeneous group of intermediaries. They differ in various attributes, such as, size, nature of incorporation and regulation, as well as the basic functionality of financial intermediation. Notwithstanding their diversity, NBFIs are characterised by their ability o provide niche financial services in the Indian economy. Because of their relative organisational flexibility leading to a better response mechanism, they are often able to provide tailor made services relatively faster than banks and financial institutions. The Non-Banking Financial Institutions(NBFIs) flourished in India in the decade of the 1980s against the back drop of a highly regulated banking sector. While the simplified sanction procedures and low entry barriers encouraged the entry of a host of NBFIs, factors like
flexibility, timeliness in meeting credit needs and low operating cost provided the NBFIs with an edge over the banking sector. NBFIs proliferated by the early 1990s. This rapid expansion was driven by the scope created by the process of financial liberalization in fresh avenues of operations in areas, such as, hire purchase, housing, equipment leasing and investment. The business of asset reconstruction has recently emerged as a green field within this sector following the passage of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002.

NBFIs are financial intermediaries engaged primarily in the business of accepting deposits delivering credit. They play an important role in channelising the scarce financial resources to capital formation. NBFIs supplement the role of banking sector in meeting the increasing financial needs of the corporate sector, delivering credit to the unorganised sector & to small local borrowers. All NBFIs are under direct control of RBI in India. A Non-Banking Financial Institution (NBFI) is a company incorporated under the Companies Act, 1956 and conducting financial business as its principal business. In contrast, companies incorporated under the same Act but conducting other than financial business as their principal business is known as non-banking non-financial institutions. NBFIs are different from banks in that an NBFI cannot accept demand deposits, issue checks to customers, or insure deposits through the Deposit Insurance and Credit Guarantee
Corporation (DICGC). In India, the non-banking financial sector comprises a multiplicity of institutions, which are defined under Section 45 I (a) of the Reserve Bank of India Act, 1934. These are equipment leasing companies (EL), hire purchase companies (HP), investment companies, loan companies (LCs), mutual benefit financial companies (MBFC), miscellaneous non-banking companies (MNBC), housing finance companies (HFC), insurance companies (IC), stock broking companies (SBC), and merchant banking companies (MBC). A non-banking company which conducts primarily financial business and belongs to none of these categories is called a residuary nonbanking company (RNBC).

While most institutions of India’s non-banking financial sector are also found in other countries financial systems, two of them, MBFIs and MNBCs, better known as Nidhis and Chit Fund Companies, respectively, are genuinely Indian institutions and rarely found outside South Asia. Inside India, they are most popular in Tamilnadu and Kerala, from where they have originated. A Nidhi does business only with its equity share holders. Much like a cooperative bank, a Nidhi accepts deposits and makes loans, which are mostly secured by jewellery. A chit fund, in Kerala also known as kuri, is a particular form of a rotating savings and credit association (ROSCA), which is most easily explained by means of an example. Twenty people, say, agree to contribute a fixed amount of 1,000 every month. So the group Pools in 20,000 each month as prize money. Every month an auction is held
and in each auction, the bidder who offers the highest discount is given the prize money $1$ minus the discount. For example, when a member bids 4,000, she/he will be paid 16,000. The discount of 4,000 is equally shared by all members. In this example, each member thus earns a dividend of 200. The winner of an auction continues to pay the monthly contribution but is not eligible to bid in subsequent auctions. According to this system, after 20 months each member will receive the prize exactly once, at which point the chit fund comes to an end. MNBC or Chit Fund Company acts as commercial organizer of Chit Funds. Financial intermediation in chit funds takes place instantly and members’ contributions do not appear as deposits on Chit Fund Companies balance sheets. For 2004, the turnover in registered chit funds is estimated at 20,000 crore.

NBFIs are essential to a country’s financial system. NBFIs provide services not well suited for banks. Banks primarily provide payment services and liquidity. Since banks have to maintain the value of deposits, they tend to have mostly debt type, as opposed to equity type, items on both side of their balance sheet. In contrast, NBFIs can finance riskier borrowers and intermediate equity claims. They thus offer a wider range of risks to investors, which encourage investment and savings, and create a market for risks. Second, NBFIs unbundled services that are bundled within a universal bank, and thus foster competition, which benefits customers. Third, through
specialization, NBFIs can gain informational advantages over banks in their narrowly defined fields of operation.

Fourth, NBFIs diversify the financial sector, which may alleviate a systemic crisis. Are the functions performed by NBFIs important for economic growth? Recent research with cross country data sets has established that development of the financial sector has the potential to accelerate economic growth. However, no research on the particular role of NBFIs in this process has yet been undertaken. Nevertheless, international comparisons show that economies with lower per capita income tend to have a smaller range of equity type claims and a smaller market share of NBFIs relative to banks.

An important and widely discussed issue in the context of financial institutions is regulation. NBFIs are particularly important for facilitating storage of value and intermediation of risk.

Moreover, like other financial institutions, they are sensitive to runs and herding behaviour. If the financial sector does not work smoothly, high transaction costs, lack of confidence and short sightedness of economic actors, as well as a culture of corruption may result. The objectives of financial sector regulation are protection against systemic risks (like depositor runs), consumer protection, efficiency enhancement, and social objectives. The regulations may be structured either institutional or functional level. Under the former, each financial institution has its own
regulatory agency, e.g. one for each category of NBFI. Under the latter, there are separate agencies for each function of an NBFI, e.g. one for deposit-taking activities, one for lending, one for market-conduct etc. India’s legislators have chosen a mix between these two models. RBI regulates ELs, HPs, Investment Companies, LCs and RNBCs. Similarly, HFCs, ICs, SBCs and MBCs report to the National Housing Bank, the Insurance Regulation and Development Agency (IRDA), and the Stock and Exchange Board of India (SEBI), respectively. All these are instances of institutional regulation. In contrast, Nidhis report to the Department of Company Affairs (DCA) and Chit Fund Companies to the State Registrar of Chit Funds for their general operations, as well as to RBI for their deposit taking activities, an instance of functional regulation. To achieve the objectives of efficiency enhancement and protection against systemic risks, regulation has to be neutral. This means that institutions providing the same or similar services should be subject to identical regulatory requirements. Regulatory neutrality fosters efficiency enhancing competition between institutions as each service will be provided by the institution which can provide it at the lowest cost. Deviations from regulatory neutrality, on the other hand, likely cause efficiency losses. Suppose that two institutions can provide a particular service at the same cost under regulatory neutrality but that, for no apparent reason, one of the two institutions is regulated less strictly. If regulatory requirements are costly to firms, that institution obtains
a regulatory comparative advantage and will drive the more regulated one out of the market, an example of regulatory arbitrage. Moreover, if differences in regulatory requirements are big, less regulated institutions may drive out more efficient ones. In this worst case, the outcome will be both inefficient and fragile, as institutions which meet the lowest among all regulatory standards dominate the market. Much of the history of NBFIs in India over the last fifty years can serve as a case study of non-neutral regulation and consequent regulatory arbitrage. Before 1997, RBI’s supervision of NBFIs was limited to prescription of prudential norms and thus the structure of NBFIs’ assets. No requirements were in place regarding minimum capital, amount and term structure of deposits, and interest rates on deposits and loans. At the same time the banking sector was heavily regulated through excessive statutory liquidity requirements, directed lending initiatives, and interest rate caps. NBFIs, which were not subject to any of these rules, thus enjoyed a substantial regulatory comparative advantage for several bank-type activities, most notably lending and deposit taking. Consequently, between 1981 and 1996, the number of NBFIs grew more than seven-fold and the share of non-bank deposits increased from 3.1 to 10.6 per cent. Several companies were extremely leveraged and deposits to Net owned funds (NOF) ratios in excess of 40 not uncommon. Numerous bankruptcies of NBFIs in the early 1990s prompted RBI to take action. The measures sanctioned in 1997, most notably minimum NOF and a
maximum deposits to NOF ratio of 1.5 and 4 (depending on the company’s rating), brought NBFI standards closer to those of the banking sector. Subsequently the number of registered NBFI s shrank by seventy per cent between 1997 and 2003. Nevertheless, NBFI s continue to enjoy regulatory privileges. The 1997 provisions were not applied uniformly across NBFI s. In particular, Nidhis as well as RNBCs were exempt from maximum deposits to NOF ratios and, partly, from interest rate ceilings. As it stands, substantial deviations from regulatory neutrality and resulting inefficiencies continue to be common features of the NBFI sector. While the regulatory measures implemented over the last ten years are steps into the right direction, regulators still have to go long ways to create an environment in which banking and non-banking financial institutions compete on even grounds.

1.4. Development of Regulatory Frame Work for NBFI s

The regulatory frame work for NBFI s had been in existence since 1963 under the provisions of Chapter III B of the Reserve Bank of India Act and the Directions issued. The regulation of the deposit acceptance activities of the Non-Banking Finance Institutions (NBFI s) was initiated in the sixties with a view to safeguard depositors’ interests and to ensure that the NBFI s function on healthy lines. Accordingly, in 1963, a new Chapter III B was inserted in the Reserve Bank of India Act, 1934 to effectively supervise, control and regulate the deposit acceptance activities of these institutions.
The Bhabatosh Datta Study Group (1971) set up to examine the role and operations of NBFIs. Recommended that NBFIs should be classified into ‘approved’ and ‘nonapproved’ categories and the regulation should be centered primarily on the ‘approved’ (i.e. those which satisfy certain additional requirements such as adequate amount of capital, reserves, liquid assets, etc.) NBFIs. Subsequently, the regulatory framework suggested by the James Raj Study Group (1974) aimed at keeping the magnitude of deposits accepted by NBFIs within reasonable limits and ensuring that they were in conformity with the objectives of monetary and credit policy.

The provisions of Chapter III B of the RBI Act, 1934, however, conferred very limited powers on the Reserve Bank. The legislative intent was aimed at moderating the deposit mobilization of NBFIs and thereby to providing indirect protection to depositors by linking the quantum of deposit acceptance to Net Owned Fund. Thus, the directions were restricted to the liability-side of the balance sheet, and too, solely to deposit acceptance activities. It did not extend to the asset-side of the balance sheets of NBFIs. Subsequently, several experts/working groups which examined the functioning of NBFIs were unanimous about the inadequacy of the legislative framework and reiterated the need for enhancing the extant framework. The Chakravarthy Committee, in its Report submitted in 1985, recommended for the introduction of a system of licensing for NBFIs in order to protect the interests of depositors. Thereafter, the Narasimham
Committee (1991) outlined a framework for streamlining the functioning of NBFIs. The Narasimham committee was of the view that, keeping in mind the growing importance of NBFIs in the financial intermediation process and their resource to borrowing, regulatory framework to govern these institutions should be specified. Such framework should include, in addition to the existing requirements of gearing and liquidity ratios, norms relating to capital adequacy, debt equity ratio, credit concentration ratio, adherence to sound accounting practices, uniform disclosure requirements and asset valuation. Further, the committee argued that the supervision of these institutions should come within the purview of the proposed agency to be set up for this purpose under the aegis of the Reserve Bank of India. The introduction of suitable legislation was deemed as essential not only for ensuring sound and healthy functioning of NBFIs, but also for safeguarding the interests of depositors.

The regulatory attention has been utilized to enable intensified surveillance of NBFIs accepting public deposits. The Reserve Bank issued directions relating to acceptance of public deposits prescribing, (a) the quantum of public deposits (b) the period of deposits which should not be less than 12 months and should not exceed 60 months, (c) the rate of interest payable on such deposits subject to a ceiling of 16 percent, (d) the brokerage fees and other expenses amounting to a maximum of 2 per cent and 0.5 per cent of the deposits, respectively, and, (e) the contents of the application forms as
well as the advertisement for soliciting deposits. The companies which accept public deposits are required to comply with all the prudential norms on income recognition, asset classification, accounting standards, provisioning for bad debts, capital adequacy, credit/investment concentration norms, etc. The capital adequacy ratio has been fixed at 12 per cent and above, in accordance with the eligibility criteria for accepting public deposits. The credit and investment concentration norms have been fixed at 15 per cent and 25 per cent of the owned funds, depending on whether the exposure is to a single borrower to a borrower group, while the totality of loans and investment has been subject to a ceiling of 25 per cent and 40 per cent of the owned fund, respectively, depending on whether the exposure is to a single party or to an industry group.

The NBFIs not accepting public deposits would be regulated in a limited manner. Such companies have been exempted from the regulations on interest rates, period as well as the ceiling on quantum of borrowings. The ceiling on the aforesaid factors for NBFIs accepting public deposits is expected to act as a benchmark for NBFIs not accepting public deposits. However, prudential norms having a bearing on the disclosure of true and fair picture of their financial health have been made applicable to ensure transparency in the financial statements to these companies, excepting those relating to capital adequacy and credit concentration norms.
1.5. Evolution of Non Banking Financial Institutions - World Scenario

Initially NBFIs started out as support companies for industrial houses. Their purpose was to act as a fixed deposit collection front and at best, work out leasing deals for the clients of these industrial houses. Soon the need for NBFIs to assume a larger role as financial intermediaries involved in efficient allocation of monetary resources started to surface. Their product and service profile changed with the addition of new products like Hire Purchase and Leasing (Ravichandran, 1999) especially on funding of motor vehicles. The demand for vehicle finance was substantial as banking industries were no way interested in financing of the vehicle and they had no knowhow or expertise for it. The situation was that there were no entry barriers or restrictions to the growth of NBFIs and because of the vehicle finance advantages NBFIs grew frantically.

Simultaneously deposits of NBFIs also increased and the main reasons for the growth of deposits with NBFIs were the greater customer orientation and higher rate of interest offered by them as compared to banks. Both Government of India and RBI were concerned about the frantic growth of NBFIs in terms of their numbers and in terms of deposits held by these companies. In recognition of the fact NBFIs are the integral part of the money market, from time to time various study groups have been appointed by Government of India and RBI for examining the role and the regulatory
framework of NBFIs. Banking companies were also reluctant and unwilling to go in for vehicle finance except that they were to compulsorily lend under priority sector for driver/owner driven vehicle under self employment schemes. NBFIs have thrived on their business till about mid 90s by when banking companies and other financiers knowing the taste of it entered the vehicle finance. Thereafter competition to NBFI vehicle financing was substantial especially from multinational banks and new generation banks. Competition was substantial especially in terms of reduced interest rate in banking companies their cost of fund being much lower.

Non banking finance industry had a very big jolt in 1998 with the RBI’s introduction of prudential norms on 2 January 1998 based on recommendations of various committees. There was a shake out for large number of erring NBFIs and the mushroom growth of NBFIs were totally arrested thereafter. Of course, all these were for the protection of the depositors and since then the number of deposit accepting NBFIs have drastically come down. Since 1998 banking companies were involved in competition in vehicle finance and NBFI faced many problems. From the developments, it is felt necessary to have a detailed study on the receivable management of the NBFIs to protect and sustain them.

In olden days finance companies were set up to provide credit to household or firms usually to purchase appliances or equipments. The first known
example in the United States of America was a retailer providing instalment credit to its customers in a New York furniture company of Copper Wait and Sons which began this practice in 1807. However, instalment credit really took off with the beginning of mass marketing of automobile from about 1915. Automobile companies set up specialised subsidiaries called finance companies to provide instalment credit to car buyers and finance the inventories of dealers and suppliers. Globally, finance companies have competed successfully with the banks when they chose automobile loans.

1.6. Regulation in Few Select Countries of Non Banking Financiers

The countries selected include U.K., U.S.A, Australia, Germany, Malaysia, Hong Kong, Singapore, Bangladesh, and Pakistan. These countries are selected because of special features of NBFIs in these countries in order to concretise the use of regulation of NBFIs in India.

1. The U.K. has a well diversified financial system. NBFIs are regulated by a separate legislation and the SRO (Self Regulatory Organisations) concept has been well received by U.K.

2. In U.S.A., NBFIs are governed by the depository institutions Deregulation and Monitory Control Act of 1980 (DIDMCA).

3. In Australia, NBFIs are regulated by the act which operates concurrently with state and territory laws and many NBFIs were converted into banks in recent years.
4. In Germany, a different set of regulations is laid down for each category of NBFIs.

5. In Malaysia, a wide variety of institutions are operating in an environment of macroeconomic stability.

6. In Hong Kong, a single set of regulations governs both banks as well as deposits taking institutions.

7. In Singapore, finance companies operate along the same line as commercial bank except that they cannot operate current account.

8. In Bangladesh, NBFIs represent one of the most important part of the financial system. However NBFIs are new in the financial system as compared to banking finance institution.

9. In Pakistan, over the last many years the non banking financial sector has carved out a place in the financial market. The regulatory environment strengthened with increased comprehensive prudential regulations.

Thus, regulatory framework for governing NBFIs in each of the countries has special features and has relevance one way or other to the Indian situation.

1.7. Evolution of Non Banking Financiers in India

Initially in India, Non Banking Financial Intermediaries (NBFI) started out as support companies for industrial houses. By 1970s and 803 many finance companies expanded their activities beyond their area of expertise. One of
the important reasons was their desire for diversification. In India, marked growth in non financial sector was noticed in the last two decades of the 20" century. The NBFIs as a group has succeeded in broadening the range of financial services rendered to the public during that period. The most important activities of NBFIs in India was the acceptance of deposits from the public ie, the liability part of it and of course investing this money by financing on vehicles either in the fond of Higher Purchase or Leasing.

1.8. Concept of Non Banking Financial Institutions in India

NBFI is a business entity incorporated under the Companies Act, 1956 and registered with Reserve Bank of India. NBFI’s regulator is the Central Bank of the country, ie., the Reserve Bank of India (RBI) and it is compulsory that all NBFIs should be registered with RBI except few like insurance companies, stock broking companies, mutual fund managers, housing finance companies, etc who have separate regulators. RBI is vested with powers to regulate the NBFIs by the RBI Act, 1934 which was comprehensively amended in 1997. NBFIs devote their resources in providing financial services of various descriptions which are distinct from the normal role of banking.

1.8.1. Major Differences between Banks and NBFIs

NBFIs are doing business akin to that of banks, however there are few differences.
(a) NBFIs cannot accept demand deposits.

(b) NBFIs are not part of the payment and settlement system and as such cannot issue cheques to its customers.

(c) Deposit insurance facility of Deposit Insurance Credit Guarantee Corporation (DICGC) is not available for NBFI deposits unlike banks.

1.8.2. RBI Definition of NBFI

NBFI has been defined under clause (I) paragraph 2 (1) of Non Banking Financial Institutions (Reserve Bank) Directions, 1977 as “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).”

1.8.3. Types of NBFIs

According to the above definitions, the NBFIs comprise the business organizations carrying on the following types of activities.

(a) Hire Purchase Finance Company

(b) Equipment Leasing Company

(c) Loan Company

(d) Investment Company

(e) Mutual Benefit Finance Company
Each of the above kinds of companies has been further defined under different clauses of paragraph 2 (1) of the said RBI Directions 1977 as reproduced below.

(a) *Hire Purchase Finance Company*: “Hire purchase Finance Company” means any company which is a financial institution carrying on as its principal business Hire Purchase transactions or the financing of such transactions.

(b) *Equipment Leasing Company*: "Equipment Leasing Company" means any company which is a financial institution carrying on as its principal business the activity of leasing of equipment or the financial of such activity.

(c) *Investment Company*: “Investment Company" means any company which is a financial institution carrying on as its principal business the acquisition of securities

(d) *Loan Company*: “Loan Company" means any company which is a financial institution carrying on as its principal business, the providing of finance, whether by making loans or advances or otherwise for any activity other than its own but does not include an Equipment Leasing Company or a Hire Purchase Finance Company.
(e) Mutual Benefit Financial Company: "Mutual Benefit Company" means any company which is a financial institution and which is notified by the Central Government under the Section 620A of the Companies Act 1956.

It is worthwhile to note that Mutual benefit Companies are also known as “Nidhi Companies” (these companies being functioning for mutual benefit) and these companies are directly controlled by Company Law Board and Central Government under various provisions of Companies Act. Much of the guidelines applicable to other NBFCS are not applicable to such Nidhi companies/Mutual benefit companies.

1.9. Differences between Non-Banking Finance Institutions and Banks

The difference between banks and NBFIs is mainly in the nature of the liabilities of the two and, to some extent, in the structure of their assets. While the liabilities of commercial banks usually consist of demand and time deposits, those of NBFIs do not ordinarily include demand deposits, the mutual benefit financial companies, commonly known as Nidhis, being notable exceptions. Since demand deposits which are withdrawal by cheque are considered to be a component of ‘money’, it is the degree of moneyless of the liabilities of the two types of institutions which constitutes a major difference between the two. From the point of view of assets held, it may be said that commercial banks hold a wide variety ranging from short term and medium term to long term credits and they also use various credit
instruments like overdrafts, cash credits, bills, etc. On the other hand, the assets of NBFIs are more specialized. For instance, hire purchase finance companies confine their operations mainly to the financing of transport operations and consumer credit while housing finance companies make loans for housing purpose. It may, however, be stated that the difference in the nature of assets held by commercial banks on the one hand and those held by NBFIs on the other does not clearly demarcate the respective fields of the two because commercial banks are also, of late, making advances in fields like transport and consumer credit, which were earlier considered as out of their purview.

Many activities and functions of NBFI’s are similar to those of banks. The distinction between them has become considerably blurred. It is true that NBFIs, unlike banks, are still not a part of payments mechanism. They cannot create money but in many other respects, they are substitution and complementary with banks. NBFIs are doing functions akin to that of banks; however there are a few differences: (i) An NBFI cannot accept demand deposits; (ii) An NBFI is not a part of the payment and settlement system and as such an NBFI cannot issue cheque drawn on itself; and (iii) Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available for NBFI depositors unlike in case of banks.
1.10. Current Scenario of Non-Banking Finance Institutions

Global credit crisis followed by increase in interest rates in October and November 2008 resulted in widespread crisis of confidence. Chain of events after the collapse of Lehman Brothers is still fresh in the minds of investors. Non-Banking Finance Institutions (NBFIs) in India were severely impacted due to economic slowdown coupled with fall in demand for financing as several businesses deferred their expansion plan. Stock prices of NBFIs’ crashed on the back of rising non-performing assets and several companies closed their operations. International NBFIs’ still continue to close down or sell their back end operations in India. The positive news however is that, this crisis has forced NBFIs to improve their operations and strategies. Industry experts opine that they are much more mature today than they were during the last decade. Timely intervention of RBI helped reduce the negative effect of credit crunch on banks and NBFIs. In fact, aggressive strategies helped LIC Housing Finance to grab new customers (including customers of other banks) and increase its market share in national mortgage market. Surprisingly it was able to maintain its profitability in 2009 (around 37%). HDFC, the largest NBFI in India, however experienced a slowdown in customer growth due to stiff competition, especially from LIC Housing Finance and tight monetary conditions. Other NBFIs that were stable during this period of credit crunch are Infrastructure Development Finance Company (IDFC) Power Finance Corporation (PFC) and Rural
Electrification Corporation (REC). Growth prospects are strong for these companies given the acute shortage of power in the country and expected increase in demand for infrastructure projects. The segment which was hit hardest was Vehicle Financing. Companies financing new vehicle purchases experienced a drastic reduction in new customer numbers. Fortunately, since vehicle finance is asset based business; their asset quality did not suffer as against other consumer financing businesses. Contrary to this, Shri ram Transport Finance, the only NBFI which deals in second hand vehicle financing was able to maintain its growth primarily due to its business model which does not entirely depends on health of the auto industry. There are thousands of market players in the NBFI sector. About 41,000 NBFI's were there during 1997. The majority of the NBFI's are private limited companies and rest being public limited companies. The number of NBFI's which regularly report or submit returns to the RBI/NHB is quite small in relation to the total number of companies at work. The important reasons for the growth of non banking finance companies are a) they provide tailor made services to the clients; b) there has been a comprehensive regulation of NBFI's; c) customers have been attracted to them by their higher level of customer orientation, lesser ore/post sanction requirements, simplicity and speed of their services; d) the monetary and credit policies have created an unsatisfied fringe of borrowers, i.e. the borrowers outside the purview of banks. The NBFI's have catered to the needs of this section of borrowers; e)
the relatively higher interest rates offered by them on deposits have attracted a large number of small savers towards them. The Resources of NBFIs

- The resources of NBFIs are derived from deposits (regulated and exempted), and net owned funds.
- Deposits means, any money received by a non-banking company by way of a deposit or loan or in any other form (apart from usual deposits, i.e. interoperate loans, borrowing by Pvt. limited NBFIs from their shareholders.
- Regulated deposit means, a deposit which is subject to certain ceiling and other restrictions imposed by regulatory measures. It includes (a) nonconvertible debentures (b) deposits received by companies from their shareholders (c) deposits guaranteed by directors (d) fixed deposits etc. received from the public (e) interoperate deposits.
- Exempted deposits signify those types of deposits/borrowings which are outside the scope of the regulatory measures. It includes (a) borrowings from banks and specified financial institutions. (b) money received from central/state/foreign governments. (c) security deposits. (d) Advances received against orders (e) convertible debentures.
- And net owned funds means the aggregate of paid up capital and free reserves.
1.11. Role of Non-Banking Finance Institutions

NBFIs like banks and other financial institutions act as intermediaries between the ultimate savers and the ultimate borrowers. The rationale of their existence derives from the fact that in an economy there are surplus units which save and deficit units which are in need of such savings and a mechanism is needed to bring the two together. Surplus units (savers) can lend to the deficit units (borrowers) directly. This, however, is normally inconvenient to both the savers and borrowers and is certainly not the most efficient means of flow of funds between the units. With the mediation of financial institutions, there is a reduction in the degree of risks involved and there is also a more efficient utilization of the resources in the economy. Financial intermediaries can provide a more economical service because of the economies of scale, their professional expertise and their ability to spread the risk over a large number of units. Thus, their operations give to the saver the combined benefits of higher return, lower risk and liquidity. The borrowers on the other hand also get a wider choice on account of intermediation of financial institutions. It may be of relevance to note that while the loans granted by commercial banks are, by and large, for industrial, commercial and agricultural purposes, those granted by NBFIs are generally for transport, trading, acquisition of durable consumer goods, purchase and repair of houses or just for plain consumption. Since their activities are not controlled by monetary authorities to the same extent as
those of commercial banks, the credit extended by NBFIs may not necessarily be in consonance with national objectives and priorities. The major function of financial intermediaries is to transfer the savings of surplus units to deficit units; hence, they can play a useful role in the economy of the country. To the extent that they help in monetizing the economy and transferring unproductive financial assets into productive assets, they contribute to the country’s economic development. In fact, the nature and diversity of financial institutions themselves have become measures of economic development of a country. The Reserve Bank of India expert committees identified the need of non banking financial companies in the following areas:

- Development of sectors like transport and infrastructure
- Substantial employment generation
- Help and increase wealth creation
- Broad base economic development
- Irreplaceable supplement to bank credit in rural segments
- Major thrust on semi-urban, rural Areas and first time buyers/users
- To finance economically weaker sections.
- Huge contribution to the state exchequer.

With a view to protecting the interests of depositors, the regulatory attention was mostly focused on NBFIs accepting public deposits (NBFS-D) until
recently. Over the last few years however, this regulatory framework has undergone a significant change, with increasingly more attention now being paid to non-deposit taking NBFIs (NBFIs-ND) as well. This change was necessitated mainly on account of a significant increase in both the number and balance sheet size of NBFIs-ND segment which gave rise to systemic concerns to address this issue. NBFIs-ND with asset size of 100 crore and above was classified as systemically important NBFIs (NBFIs-ND-SI) and are subjected to ‘limited regulations’. The changing regulatory policy also recognized that those activities of NBFIs which are asset creating must be given special consideration. Accordingly in December 2006, a reclassification of NBFIs was effected. In terms of the new classification, companies financing real/physical assets for productive/economic activity are classified as asset finance companies (AFC), subject to the fulfilment of certain norms. The prudential norms for AFCs vary from the norms for other NBFIs. The revised NBFI classification now comprises of AFCs, loan companies (LCs) and investment companies (ICs) instead of equipment leasing, hire purchase, loan companies and investment companies earlier.

1.11.1. Protection of Depositors’ Interest

With a view to protecting the interests of the depositors further, the Reserve Bank initiated steps for creating a charge on the SLR securities in favour of the depositors. Accordingly, NBFIs accepting/holding public deposits were advised in January 2007 to create floating charge on the statutory liquid
assets in favour of their depositors, through the mechanism of ‘Trust Deed’. The charge is required to be registered with the Registrar of Companies and the information in this regard is required to be furnished to the Trustees and the Reserve Bank. Furthermore, with a view to containing the systemic risk relating to NBFIs-D, measures were initiated to ensure that only finally sound NBFIs accept deposits. It was, therefore, prescribed in June 2008 that NBFIs having net owned funds (NOF) of less than 200 lakh may freeze their deposits at the level than held by them. Asset Finance companies (AFC) having minimum investment grade credit rating and CRAR of 12 per cent may bring down public deposits to a level that is 1.5 times their NOF, while all other companies may bring down their public deposits to a lever equal to their NOF by March 31 2009.

1.11.2. Transparency in Operations of the NBFIs

Along with measures for enhancing the financial strength of NBFIs, initiatives to inculcate fair corporate governance practices and good treatment of customers were also undertaken. The Reserve Bank issued guidelines on Fair Practices Code for NBFIs in September 2006; NBFIs were advised to invariably furnish a copy of the loan agreement along with a copy each of all enclosures quoted in the loan agreement to all borrowers at the time of sanction/ disbursement of loans. Deposit taking NBFIs with deposits of 20 Crore and above and NBFIs-ND SI have been advised to frame internal guidelines on corporate governance which should include,
inter alia, constitution audit committee, nomination committee and risk management committee, among others. Certain disclosure and transparency practices have also been specified for them. NBFIs have been advised to lay down appropriate internal principles and procedures for determining interest rates and processing and other charges, even though interest rates are not regulated by the Reserve Bank. In order to ensure that only NBFIs which are actually engaged in the business of NBFI hold Certificate of Registration (COR), it has been decided that all NBFIs should obtain and submit an annual certificate from their statutory auditors to the effect that they continue to undertake the business of NBFI to be eligible for holding of COR.

To strengthen their financial viability, NBFIs were permitted in December 2006 to undertake fee based business to augment their income, subject to certain norms. The diversification business that may be permitted include, marketing and distribution of mutual fund products as agents of mutual funds and issuing co branded credit cards with scheduled commercial banks, without risk sharing, with prior approval of the Reserve Bank, for an initial period of two years and a review thereafter.

1.11.3. **Foreign Direct Investment (FDI) in NBFI sector**

In view of the interest evinced in FDI participation in the NBFI sector, regulatory measures have also been undertaken in respect of foreign direct
investment (FDI) in the NBFI sector, FDI under automatic route is permitted in respect of 18 NBFI activities, subject to prescribed minimum capitalization norms. While allowing FDI in NBFI, the Reserve Bank takes into consideration fit and proper criteria of directors, information about the overseas regulator of the companies bringing the FDI into India and inter regulatory views. Bank is monitoring minimum capitalization norms as regards FDI with a view to ensuring that NBFI activities are limited to permissible activities.

1.11.4. Monitoring of Frauds in NBFI

In March 2008 all deposit taking NBFI (including RNBCs) were advised that the extant instructions with regard to monitoring of frauds were revised and as such cases of ‘negligence and cash shortages’ and ‘irregularities in foreign exchange transactions’ were to be reported as fraud if transactions’ were to be reported as fraud if the intention to cheat/defraud was suspected/proved. However, in cases were fraudulent intention was not suspected/proved at the time of detection but involve cash shortages of more than ten thousand rupees and cases where cash shortages more than five thousand rupees were detected by management/auditor/inspecting officer and not reported on the occurrence by the persons handling cash, then such cases may also be treated as fraud and reported accordingly. Prevention of Money Laundering Act, 2002 – Obligation of NBFI; It was reiterated in August 2008 that NBFI, as a part of transaction monitoring
mechanism, are required to put in place an appropriate software application to throw alerts when the transactions are inconsistent with risk categorization and updated profile of customers. In the case of NBFIs, where all the branches are not yet fully computerized, the Principal Officer of the NBFI should cull out the transaction details from branches which are not computerized and suitably arrange to feed the data into an electronic file with the help of the editable electronic utilities of cash transaction report (CTR) and suspicious transaction reports (STR) as have been made available by Financial Intelligence Unit-India (FIU-IND) on their website. It was further clarified that cash transaction reporting by branches/offices of NBFIs to their Principal Officer should invariably be submitted on a monthly basis and the Principal Officer, in turn, should ensure to submit CTR for every month to FIU-IND within the prescribed time schedule.

1.11.5. Facility of Liquidity Support for NBFIs

On October 15, 2008 the Reserve Bank announced, purely as temporary measure, that banks may avail of additional liquidity support exclusively for the purpose of meeting the liquidity requirements of mutual funds (MFs) to the extent of up to 0.5 per cent of their NDTL. Further, it was decided, on a purely temporary and ad hoc basis, subject to review, to extend this facility and allow banks to avail liquidity support under the LAF through relaxation in the maintenance of SLR to the extent of up to 1.5 per cent of their NDTL. This relaxation in SLR is to be used exclusively for the purpose of meeting
the funding requirements of NBFIs and MFs. Banks can apportion the total accommodation allowed above between MFs and NBFIs flexibly as per their business needs.

1.11.6. Policy Initiatives for NBFIs-ND

The number, product variety and size of NBFIs-ND-SI have witnessed substantial growth in recent years and as a result the operations of these companies have increasingly assumed systemic implications. As a response to these developments, the ‘minimal regulatory regime’ that existed for these companies has been transformed into ‘limited regulatory regime’ by the Reserve Bank. In line with the growing focus on NBFIs-ND in recent years, certain important policy initiatives were undertaken in 2007-08.

1.12. Miscellaneous Non-Banking Companies (MNBCs)

MNBCs are mainly engaged in the Chit Fund business. The term 'deposit' as defined under Section 45 I of the Reserve Bank of India Act, 1934 does not include subscription to Chit Funds. The Chit Fund companies have been exempted from all the core provisions of Chapter III B of the RBI Act including registration. In terms of Miscellaneous Non-Banking Companies (RBI) Directions, the companies can accept deposits up to 25 percent and 15 percent of the NOF from public and shareholders, respectively, for a period of 6 months to 36 months, but cannot accept deposits repayable on demand/notice. A study group on Miscellaneous Non-Banking companies
(RBI) during 1997 headed by Dr. Bhabatosh Dutta reviewed the role of various non banking financial institutions it observed that the chit funds were not efficient as saving or lending institutions and they encouraged consumption spending and in some cases hoarding of scarce commodities. As elimination of chit funds would leave credit gap they should be regulated by appropriate legislation to ensure safeguarding the interests of the members. In 1974 a study group headed by Dr.J.S.Raj observed that prize chits or benefit schemes do not serve any social purpose, on the contrary they are prejudicial to public interest also adversely affecting the efficiency of fiscal and monetary policy. The study group therefore recommended the total ban of the conduct of Prize Chits. In 1978 the Prize Chits and Money Circulation Schemes (Banning) Act 1978 was enacted. As a follow up of the recommendations of the Raj Committee a set of directions were issued by the Reserve Bank called the Miscellaneous non banking(Reserve Bank) Directions, 1977 regulating the working of the conventional chits.

The Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 1977 came into force with effect from the 1st July, 1977. These directions shall apply to every financial institution which is a company and which carries on in any place in the State of Jammu and Kashmir, any of the following types of business and to every financial institution which is a company and which carries on, in any place in India, any of the mentioned types of business referred to collecting whether as a promoter, foreman,
agent or in any other capacity, monies in one lump sum or in instalments by way of contribution, or subscription or by sale of units, certificates or other instruments or in any other manner or as membership fees or admission fees or service charges to or in respect of any savings, mutual benefit, thrift, or any other scheme of arrangement by whatever name called, and utilizing the monies so collected or any part thereof or the income accruing from investment or other use of such monies. Managing, conducting or supervising as a promoter, foreman or agent of any transaction or arrangement by which the company, enters into an agreement with a specified number of subscribers that every one of them shall subscribe a certain sum in instalments over a definite period and that every one of such subscribers shall, in his turn as determined by lot or by auction or by tender or in such other manner as may be provided for in the arrangement be entitled to the prize amount. Conducting any other form of chit or kuri which is different from the type of business referred above.

1.13. Statement of the Problem

Non-Banking Financial Institutions (NBFIs), especially the leasing and hire purchase companies, has recorded marked growth in recent years reflecting evolution of a vibrant, competitive and articulate financial system (Khan.M.Y.2003). Non-Banking Financial Institutions are heterogeneous in their ownership patterns and regulations affect unevenly even within the broad category. Financial performance is impacted by regulations,
competition and fund mobilization, deployment (Narasimhan.C.R.L.2006). The numbers of deposit taking Non-Banking Finance Institutions are coming down as a result of erosion of investor’s confidence, cost of operations (Narasimhan.C.R.L.2004). Contagion is less limited to non-banking financial sector than banking sector as far as its effect on economy is concerned in UK (Corder Mathew 2004). The restrictions on bank finance and group exposure will also have a marginally adverse impact on the resource profile of the Non-Banking Finance Institutions (Sitaraman Krishnan 2007).

Banks have lower cost of funds than Non-Banking Financial Institutions and the rising borrowing cost has resulted in contraction of their profitability. Asset Finance Companies’ market share in truck financing has declined substantially, which has affected their business (Vemuti Somasehar 2007). The key drivers of performance of financial institutions are the riskiness of assets, demography and geographical spread and also affect the profitability (Krishnan Sitaraman 2004). Which are the drivers of performance of the financial institutions? Whether is it management strategy and its execution, environment (regulation, economy) that affects the performance? (Harker Patrick T, Stavros A Zenios.1998). Spreads are likely to reduce in capital market financing as a result of increasing competition (Gupta Megha 2007). There has a significant shift in asset deployment away from the business of leasing, hire purchase towards loans, ICDs and investments. Overall cost of
funds is higher for Non-Banking Financial Institutions than for banks and returns have shrunk and operating cost have sharply increased resulted in closure of number of finance companies (Ingres 2005).

NBFIs that carry out vehicle financing have to compete with their banking counterparts and other financial institutions in a market which is not a level playing ground. They have to battle with the institutions whose cost of funds is much lower than theirs. This means, that the quality of NBFI customers is likely to be lower than that of banks. Because of that they have to hunt vigorously for customers using various marketing tactics and add-on services. In such a situation, NBFI may fund low grade customers and hence their quality of assets and position of receivables will be weak. This necessitates the need for a better collection policy in NBFIs.

Financiers operating on a thinner margin will have reduced profitability for their organisation. Reducing expenditure and increasing the volume resolves the problem to some extent. Rise in volume and fall in expenditure leads to rise in recovery problems. When there are more recovery problems, write off is required and thus leads to fall in profitability. Apart from that the credit rating and classification of NBFIs is also affected. This results in reduction in deposit acceptance based on the regulations of RBI. Financiers do have resource constrain and many of them depend on their access to public deposits. Due to receivable problems, access to public deposit is likely to be denied or the quantum of deposit held. This necessitates
refunding of deposits which ultimately lead to stoppage of lending due to resource crunch. Once lending is stopped, customers will be lost one by one and the morale of employees will also go down. With this, the collection of existing portfolio itself become difficult and can lead to change in situation in business or even winding up of the company.

Delivery channels are crucial for cost and profit efficiency of financial institutions (Klumpes 2004). Operational reforms such as deregulation of bank finance, movement to loan financing have helped efficiency of the financial sector (Varma Jayanth R 2001). The asset turnover ability, return on funds deployed and return to investors is the useful guide to companies to decide about diversification or continuation (Kantawala Amita S 2004).

From the above and the industry publications, the problems that these companies are facing today are

- Highly competitive asset financing environment
- Reduced return on lending
- Lack of business strategy to ward off competition.
- Economic factor viz., inflation, impacts the operations, and the performance.
- Regulations on income recognition, and prudential norms affect the earnings and profitability
Since, the previous researchers have not dealt with the above factors sufficiently, the present research attempts to identify factors internally affecting the operation of Asset Finance Companies (Formerly, equipment leasing and hire purchase finance companies) and suggests an appropriate model to understand the mediating factors affecting the performance of these companies.

In India, the NBFIs have witnessed substantial growth over the years; there are few areas of concern which need to be addressed. The NBFIs have enjoyed an edge over banks in semi-urban & rural markets where banking network is not yet strong; they have limited spread in urban markets. Nonetheless, in recent years, NBFIs have begun to create niches for themselves that are often neglected by banks. These primarily include providing finance to non-salaried individuals, traders, transporters, stock brokers, etc. in that extent it has developed and overcome the services of commercial banks functioning in the same area. In the past few years, the increased competition from banks in the retail finance segment has led to excess diversification by NBFIS from their core business activities. The sector has witnessed introduction of various innovative products such as used vehicles financing, small personal loans, three-wheeler financing, IPO financing, finance for tyres & fuel, asset management, mutual fund distribution and insurance advisory, gold loans, etc. Besides, NBFIs are aspiring to emerge as a one-stop shop for all financial services.
NBFIs have also ventured into riskier segments such as unsecured loans, purchase finance for used commercial vehicles, capital market lending, etc. The earlier mentioned factors increase their risk profile which could have adverse impact on the financial health of NBFIs. Although some improvement has been witnessed in auto sales in last few months, the demand for vehicle finance is likely to remain subdued. Besides, given the significant slowdown in the Indian economy, NBFIs are encountering structural challenges such as increased refinancing risk, short-term asset-liability mismatch leading to decelerating growth and declining margins. This is expected to have a bearing on the profitability of NBFIs in the medium term. The growth in vehicle finance remaining low in the medium term, NBFIs are expected to focus on rural and semi-urban markets. Credit requirements of rural population are primarily met by banks from organised sector or local money lenders. Though, in recent years there has been some penetration of NBFIs in this segment, the market still remains largely untapped.

There is a large section of rural population which does not have access to credit either because of their inability to meet the lending covenants of banks or due to high interest rates of local money lenders. This provides a huge opportunity for NBFI sector to spread their business in the rural & semi-urban markets. In the above juncture, the present study deals with the
performance of the select NBFIs such as Manappuram finance and Muthoot finance. The study deals with the analysis of balance sheets and income statements of the select companies.

Hence, the study on financial performance of these NBFIs helps to identify the important problems faced by NBFIs and the remedial measures to overcome the problems which lead to the better performance of the NBFIs as a whole.

**1.14. Research Objectives**

The main objective of this study is to identify factors affecting Non-Banking Financial Institutions Services and suggest a model to capture the constraining factors in a better way. Several specific goals are formulated to achieve this main objective. Based on the literature review the following objectives are formulated.

1. To examine the demographic and socio economic environments influence the different dimensions of service quality in non-banking financial institutions services in Kovai Region, Tamilnadu.

2. To develop a Structural Equation Model for the service quality measurement in non-banking financial institutions services in Kovai Region, Tamilnadu.
3. To find out the relationship between the dimensions of service quality in non-banking financial institutions services in Kovai Region, Tamilnadu.

4. To identify the meditated effects on service quality in non-banking financial institutions services in Kovai Region, Tamilnadu.

5. To suggest suitable strategic model for improving service quality in non-banking financial institutions services in Kovai Region, Tamilnadu.

1.15. Research Questions

The following research questions are quite relevant to the crucial purpose of the study and seeking to understand the mediating effects of Service Quality in Non-Banking Financial Institutions Services in Kovai Region, Tamilnadu.

1. What are the various factors/service dimensions affecting Service Quality in Non-Banking Financial Institutions Services in Kovai Region, Tamilnadu?

2. What are the parameters increases in Service Quality as for as Non-Banking Financial Institutions Services is concerned?

3. What are the relationships among the various dimensions?

4. What are the various parameters that affect the factor for of Non-Banking Financial Institutions Services in Kovai Region, Tamilnadu?
1.16. Proposed Conceptualized Research Model

There are 10 dimensions were framed for this study. Those are; i) Awareness of Services, ii) Trustworthiness, iii) Office Atmosphere, iv) Declaration of Employees, v) Understanding, vi) Payment and Charges, vii) Communication, viii) Location and Place ix) Customer Satisfaction and x) Service Quality. Here Demographic variables, Awareness of Services, Trustworthiness, Office Atmosphere, Declaration of Employees, Understanding, Payment and Charges, Communication and Customer Satisfaction are independent variables and Location and Place and Service Quality are the dependent variable. It is studied that how and what extent the independent variables make changes in the dependent variable. The proposed conceptual research model shows the process of research as follows:
1.17. **Scope of the Study**

There are manufacturing and trading organisations which can manage without credit sales because of its product advantage, pricing policies and monopolistic conditions and whereby situation of least receivable problems. In the case of NBFIs, the basic business is fund based activity like vehicle financing. Reduced lending activity suggests a drop in business. Hence the financiers should have a targeted lending. There is a limit in cutting the cost as the organisation can grow healthy by retaining their employees and maintaining quality infrastructural support. Then the area left out for cost reduction is better management of receivables. Better receivable
management is necessary for a NBFI for its survival. For example, if the receivable is not managed well, collection cost will go rise, provisioning requirement will increase and bad debt write off is necessary. Naturally profitability lowers, apart from various cascading effects discussed in earlier paragraphs. With this background, there is a need to come out these vicious problems of NBFIs and towards that the following objectives are selected.

1.18. Significance of the Study

The proposed empirical research is an attempt to study about the various Service Quality dimensions and the Service Quality of Non-Banking Financial Institutions Services. And on the other side, finding out the mediating factor for the Service Quality in Non-Banking Financial Institutions Services. The present research pays its attention to identify the dimensions of Service Quality that ensures maximum satisfaction for the Customers’ in the Non-Banking Financial Institutions Services. The Customers’ Satisfaction is the ultimate determinant of Service Quality and it decides the motivated for Non-Banking Financial Institutions Services.

1.19. Structure of the Thesis

The study is structured into five chapters organized to present the study utilizing methodology that allows it to flow from a basic introduction to empirical findings.
Chapter I: Deals with a general introduction/background of the study tracing the evolution of NBFIs, in general and operating environment including threats, opportunities available. Besides the above, this chapter gives a brief account of the institutional factors and regulatory framework within which the service quality are operating at present. It also presents the need for study and statement of problem of the study, significance of study to NBFIs and finally outlines the structure of the study.

Chapter II: Reviews literature with respect to the regulatory framework, Presents various important factors affecting the performance of service quality contained in works of several researchers, identifies the gap in past research, outlines the objectives of the study, the previous empirical findings and models developed to analyze the efficiency and performance parameters are thoroughly examined.

Chapter III: Presents a detailed discussion of research design, the research hypotheses to be tested and the methodology used to test the critical factors affecting performances and its hypotheses present a simple conceptual model for testing the critical dimensions.

Chapter IV: Summarizes the outcomes of the statistical and econometrical analysis that are used to test the hypotheses.
Chapter V: Identifies the findings of the study pertaining to the hypotheses, the implications for the sector as a whole and individually, drawn from the findings of the research, the scientific contributions, limitations, recommendations for future research and conclusions of the study.

1.20. Conclusion

This chapter examined the key Awareness of Services, Trustworthiness, Office Atmosphere, Declaration of Employees, Understanding, Payment and Charges, Communication and Customer Satisfaction are independent variables and their sub dimensions with Location and Place as the mediated factor and the Service Quality Factor. The background for the research is discussed and the research questions in this study raise the propositions to be tested. Research problem is discussed with the objective for the study and the variables associated with conceptual model, significance of the study are defined and the following chapter will review the literature of previous studies and the propositions are hypothesized to capture the criticality of the study.