CHAPTER-1

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1.1 INTRODUCTION:

Financial arrangements constitute an integral part of the process of economic development. A growing economy requires a progressively rising volume of savings and adequate institutional arrangements for the mobilization and allocation of savings. These arrangements must not only extend and expand but also adapt to the growing and varying financial needs of the economy. A well-developed and efficient capital market is an indispensable prerequisite for the effective allocation of savings in an economy. A financial system consisting of financial institutions, instruments and markets provides an effective payment and credit supply network and thereby assists in channeling of funds from savers to the investors in the economy. The task of the financial institutions or intermediaries is to mobilize the savings and ensure efficient allocation of these savings to high yielding investment project so that they are in a position to offer attractive returns to the savers.

Economic reforms in India were initiated in 1991. It has two main objectives: (1) Stabilization (2) Structural Adjustment. Stabilization is necessary to correct the macro-economic imbalances, which periodically destabilize the Indian economy, such as inflation, unsustainable fiscal
deficit, acute foreign exchange shortage and balance of payment problem. Structural adjustment is necessary to observe international standards\(^1\). The Structural Adjustment Programme (SAP) comprises basically of reforms in fiscal, trade and exchange rate policies. The policy shifts, corresponding to these reforms are clearly manifest in the on-going process towards privatization, liberalization and globalization. The kinds of reforms that India has introduced in 1991 are common. During the beginning of 1990, Indian economy was going through a period of increased financialization. The share of assets of the financial institutions to the GDP increased considerably. The nineties; have seen a drastic reduction in global barriers to competition in the financial services industry. Deregulation around the world has permitted consolidation across more distant and different types of financial institutions. The growth in cross border activities of Non-Banking Financial Companies (NBFCs) has spurred greater demands for institutions that can provide financial services across borders. Liberalization has brought about a transformation in every sector of the economy, so is the development of NBFCs in India.

Section 45-I of the Reserve Bank of India Act, 1934 defines “non-banking financial company as:

i) A financial institution which is a company;
ii) A non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme of arrangement or in any other manner or lending in any manner;

iii) Such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.

According to the Reserve Bank (Amendment Act) 1997, a NBFC is defined as, (a) A financial institution which is a company, (b) A non-banking institution which is a company and whose principal business is to receiving of deposits under any scheme/arrangement/in any other manner or leading in any manner and (c) other non banking institutions/ class of institutions as the RBI may specify.

To a vast country like India, with a diversified economic structure, multi-agency approach is adopted in the financial sector under which the savings and credit requirements of various sections of population are met. Thus both commercial banks and NBFCs have come into play in shaping the economy of the country. The Non-banking financial services Industry in the private sector in India is represented by the mix of a few large companies with nationwide presence, and a large number of small and medium sized companies with regional focus. These NBFCs provide a variety of services including fund based and fee based financial services to customers in retail and non retail markets.
In other words, Non-Banking Financial Companies (NBFCs) constitute a heterogeneous lot of privately-owned, small-sized financial intermediaries which provide a variety of services including equipment leasing, hire purchase, loans, investments and chit fund activities. These companies play an important role in providing credit to the unorganized sector and to the small borrowers at the local level. NBFCs have been the subject of focused attention since the early 1990s. The rapid growth of NBFCs has led to a gradual blurring of dividing lines between banks and NBFCs, with the exception of the exclusive privilege that commercial banks exercise in the issuance of cheques. NBFCs are widely dispersed across the country and their management exhibits varied degrees of professionalism. Furthermore, the depositors have varied degrees of perceptions regarding safety of their deposits while making an investment decision.

NBFCs have turned out to be engines of growth and are integral part of the Indian financial system, enhancing competition and diversification in the financial sector, spreading risks specifically at times of financial distress and have been increasingly recognized as complementary of banking system at competitive prices. The Banking sector has always been highly regulated, however simplified sanction procedures, flexibility and
timeliness in meeting the credit needs and low cost operations resulted in the NBFCs getting an edge over banks in providing funding.

Since the 90s crisis the market has seen explosive growth, as per a Fitch Report\(^2\) the compounded annual growth rate of NBFCs was 40% in comparison to the CAGR of banks being 22% only. NBFCs have been pioneering at retail asset backed lending, lending against securities, microfinance etc and have been extending credit to retail customers in under-served areas and to unbanked customers.

In a broader sense, NBFC means a company whose principal business is financing, in whatever form, but not qualified enough to be called a Bank as defined in Banking Regulation Act 1949. NBFC offer a variety of services. The service mix of NBFCs has all dimensions- width, depth and consistency- the three essential characteristics of any product mix. Width refers to variety, depth refers to range in each variety and consistency refers to overall synergy of the service mix. With their diversified structure and methods of business NBFCs are serving the economy in a variety of ways\(^3\).

Growth and diversification of Non-banking Financial Companies is an integral part of the development process of the financial market of the economy. NBFCs and unincorporated bodies have been competing and complementing the services of commercial banks since yester-years all
over the world. While the financial system in a country generally develops through a process of gradual evolution, it has been observed that there was a stage in evolutionary process wherein the growth of NBFCs was more pronounced than other components of the financial system. In the United States of America, the growth of NBFCs were more pronounced during the first three decades of 20th century and two of the top five commercial lenders are NBFCs and three of the four top providers of consortium finance are non-bank firms. In many countries, NBFCs have been able to serve the household, farm and small enterprises sector on a sustained basis.

Non-Banking Financial Companies do offer all sorts of banking services, such as loans and credit facilities, retirement planning, money markets, underwriting and merger activities\(^4\). The number of non-banking financial companies has expanded greatly in the last several years as venture capital companies, retail and industrial companies have entered the lending business. These companies play an important role in providing credit to the unorganized sector and to the small borrowers at the local level. Hire purchase finance is by far the largest activity of NBFCs. NBFCs have been the subject of focused attention since the early 1990s. The rapid growth of NBFCs has led to a gradual blurring of dividing lines between banks and NBFCs, with the exception of the exclusive privilege that commercial banks exercise in the issuance of cheques. NBFCs are widely dispersed across the country and their management exhibits varied
degrees of professionalism. Furthermore, the depositors have varied
degrees of perceptions regarding safety of their deposits while making an
investment decision.

The activities of non-banking financial companies (NBFCs) in India
have undergone qualitative changes over the years through functional
specialization. The role of NBFCs as effective financial intermediaries has
been well recognized as they have inherent ability to take quicker
decisions, assume greater risks, and customize their services and charges
more according to the needs of the clients. While these features, as
compared to the banks, have contributed to the proliferation of NBFCs,
their flexible structures allow them to unbundle services provided by banks
and market the components on a competitive basis. The distinction
between banks and non-banks has been gradually getting blurred since both
the segments of the financial system engage themselves in many similar
types of activities. At present, NBFCs in India have become prominent in a
wide range of activities like hire-purchase finance, equipment lease
finance, loans, investments, etc.

NBFCs are classified into various categories as per different criteria.
The first is according to liabilities where NBFCs are classified as
‘Category A companies’ and ‘Category B companies’. The second mode
classifies NBFCs as: Loan Companies (LC), Investment Companies (IC),
Asset Finance Companies (AFCs), Infrastructure Finance Companies (IFCs) and Systematically Important Core Investment Companies (CICs-ND-SI). It is important to note that while the functions of NBFCs and Banks (Banking Companies) appear to be similar, there are certain important differences between the two. Firstly, Banks are the only institutions that are capable of creating credit. Secondly, NBFCs are not covered under the scheme of Deposit Insurance & Credit Guarantee Corporation of India (DICGC). Thirdly, NBFCs are not allowed to accept demand deposits. Fourthly, NBFCs are not a part of Payment and Settlement System of RBI.

The working and operation of NBFCs are regulated by the Reserve Bank of India (RBI) within the framework of the Reserve Bank of India Act, 1934 (chapter III B) and the directions issued by it under the Act. Under the Act, it is mandatory for a NBFC to get itself registered with the RBI as a deposit taking company. This registration authorizes it to conduct its business as an NBFC. For the registration, with the RBI, a company incorporated under the Companies Act, 1956 and desirous of commencing business of non-banking financial institution, should have a minimum net owned fund (NOF) of investment of Rs.25 lakhs (raised to investment of Rs.200 lakhs w.e.f. April 21, 1999). Only those NBFCs holding a valid Certificate of Registration can accept/hold public deposits. The NBFCs accepting public deposits should comply with the Non-Banking Financial
Companies Acceptance of Public Deposits (RBI) Directions, 1998, as issued by the bank. The regulations relating to acceptance of deposits by the NBFCs are,

1. They are allowed to accept/renew public deposits for a minimum period of 12 months and maximum period of 60 months.
2. They cannot accept deposits repayable on demand.
3. They cannot offer interest rates higher than the ceiling rate prescribed by RBI from time to time.
4. They cannot offer gifts/incentives or any other additional benefit to the depositor.
5. They should have minimum investment grade credit rating.
6. Their deposits are not insured.
7. The repayment of deposits by NBFCs is not guaranteed by RBI.

The RBI has instituted a strong and comprehensive supervisory mechanism for NBFCs. The focus of the RBI is on prudential supervision so as to ensure that NBFCs function on sound and healthy lines and avoid excessive risk taking. The RBI has put in place a four pronged supervisory framework based on:

i) On-site inspection;
ii) Off-site monitoring supported by state-of the art technology;
iii) Market intelligence; and
iv) Exception reports of statutory auditors of NBFCs.
The thrust of supervision is based on the asset size of the NBFC and whether it accepts/holds deposits from the public. The system of on-site examination put in place during 1997 is structured on the basis of assessment and evaluation of CAMELS (Capital, Assets, Management, Earnings, Liquidity and Systems and Procedures) approach and the same is akin to the supervisory model adopted by the RBI for the banking system. Market intelligence system is also being strengthened as one of the important tools of supervision. This process of continuous and on-going supervision is expected to facilitate RBI to pick up warning signals, which can result in triggering supervisory action promptly. The returns being submitted by the NBFCs are reviewed and re-looked at intervals to widen the scope of information so as to address the requirements either for supervisory objectives or for furnishing the same to various interest groups on the important aspect of the working of these companies. The companies not holding public deposits are supervised in a limited manner with companies with asset size of Rs.100 crore and above being subjected to annual inspection and other non-public deposit companies by rotation once in every 5 years. The exception reports, if any, from the auditors of such companies coupled with adverse market information and the sample check at periodical intervals are the main tools for monitoring the activities of such companies’ vis-à-vis the RBI regulations.
The role of NBFCs in transferring the funds from lenders to borrowers has been well-recognized. The main advantages of these companies are as under⁵.

1. Customer orientation and prompt provision of services.
2. Concentration in the main financial centers.
3. Attractive rates of return offered.
4. Lower transactions costs of operations.
5. Quick decision-making ability.
7. Flexibility and timeliness in meeting the credit needs of specified sectors (like equipment leasing and hire purchase).

The worldwide experience shows that the important factor contributing towards the growth of NBFCs are changes in the international financial markets and the increasing integration of domestic and international markets and the rapid development of technology in the financial sector like introduction of new communication and transmission system which reduce transaction costs and speed up information flows. To an extent, all these factors have contributed to the growth of NBFCs in India, especially during the later part of eighties.
In Indian multi-tier financial system, the NBFC sector stands apart for more than one reason. Though the sector is essentially doing the job of financial intermediation, it is still not fully comparable with the other segments of the Indian financial system. This is so in view of the wide variations in the profile of the players in this sector in terms of their nature of activity (lending, investment, lease, hire purchase, chit fund, pure deposit mobilization, fee based activity, etc.), the volume of activity, the sources of funding they rely on (public deposits and non-public deposits),
method of raising resources, deployment pattern, etc. This has naturally resulted in the creation of multifarious categories of NBFCs and therefore, diverse regulatory dispensation by RBI.

In India, such marked growth in the non-bank financial sector was noticed in the last two decades. During the last two decades NBFCs have witnessed a marked growth. Some of the factors which have contributed to this growth have been lesser regulation over this sector, higher deposit interest rates offered by this sector, higher level of customer orientation, the speed with which it caters to customer needs and so forth\(^6\).

Hence, NBFCs are playing significant role in economic and financial system of India. As these are assisting in different financial activities such as leasing, hire purchase, working capital, etc, they are of immense use for businessmen. Further, few of the NBFCs are assisting persons by providing housing loans. Overall, NBFCs are playing important role in growth and development of Indian economy. It is essential to know the benefits for the investors in NBFCs in terms of dividend, profit share, etc. In this regard, the present study is made to evaluate the comparative performance of Non-Banking Financial Companies especially in housing sector.
FINANCIAL LINKAGE BETWEEN BANKS AND NBFCs

Banks and NBFCs compete for some similar kinds of business on the asset side. NBFCs offer products/services which include leasing and hire purchase, corporate loans, investment in non-convertible debentures, IPO funding, margin funding, small ticket loans, venture capital, etc. However NBFCs do not provide operating account facilities like savings and current deposits, cash credits, overdrafts etc. NBFCs avail of bank finance for their operations as advances or by way of banks’ subscription to debentures and commercial paper issued by them. Since both the banks and NBFCs are seen to be competing for increasingly similar types of some business, especially on the assets side and since their regulatory and cost-incentive structures are not identical it is necessary to establish certain checks and balances to ensure that the banks’ depositors are not indirectly exposed to the risks of a different cost-incentive structure. Hence, following restrictions have been placed on the activities of NBFCs which banks may finance:

Bills discounted / rediscounted by NBFCs, except for rediscounting of bills discounted by NBFCs arising from the sale of

a. Commercial vehicles (including light commercial vehicles);

and

b. Two-wheeler and three-wheeler vehicles, subject to certain conditions;
i) Investments of NBFCs both of current and long term nature, in any company/entity by way of shares, debentures, etc. with certain exemptions;

ii) Unsecured loans/inter-corporate deposits by NBFCs to/in any company.

iii) All types of loans/advances by NBFCs to their subsidiaries, group companies/entities.

iv) Finance to NBFCs for further lending to individuals for subscribing to Initial Public Offerings (IPOs).

v) Bridge loans of any nature, or interim finance against capital/debenture issues and/or in the form of loans of a bridging nature pending raising of long-term funds from the market by way of capital, deposits, etc. to all categories of Non-Banking Financial Companies, i.e. equipment leasing and hire-purchase finance companies, loan and investment companies, Residuary Non-Banking Companies (RNBCs).

vi) Should not enter into lease agreements departmentally with equipment leasing companies as well as other Non-Banking Financial Companies engaged in equipment leasing.
MAJOR DIFFERENCES BETWEEN BANKS & NBFCS

NBFCs are doing functions akin to that of banks; however there are a few differences, namely, A NBFC cannot accept demand deposits (demand deposits are funds deposited at a depository institution that are payable on demand immediately or within a very short period like your current or savings accounts).

• It is not a part of the payment and settlement system and as such cannot issue cheque to its customers.
• Deposit insurance facility of DICGC is not available for NBFC depositors unlike in case of banks.

1.2 SIGNIFICANCE OF THE STUDY:

According to the Economic Survey 2010-11, it has been reported that NBFCs as a whole account for 11.2 percent of assets of the total financial system. With the growing importance assigned to financial inclusion, NBFCs have come to be regarded as important financial intermediaries particularly for small-scale and retail sectors. In the multi-tier financial system of India, importance of NBFCs in the Indian financial system is much discussed by various committees appointed by RBI in the past and presently, RBI has been modifying its regulatory and supervising policies from time to time to keep pace with the changes in the system. NBFCs have turned out to be engines of growth and are integral part of the
Indian financial system, enhancing competition and diversification in the financial sector, spreading risks specially at times of financial distress and have been increasingly recognized as complementary of banking system at competitive prices. The banking sector has always been highly regulated, however simplified sanction procedures, flexibility and timeliness in meeting the credit the needs and low cost operations resulted in the NBFCs getting an edge over banks in providing funding. The report of the Finance Ministry of the Government of India revealed that there were 428 deposit taking NBFCs and their number is reduced to 297 in 2011. It shows the negative growth of the NBFCs.

On the other hand, housing has been recognized as a basic human need. Several Initiatives at the centre and state levels have focused on “housing” as an integral part of the growth process. Housing is known to have multiple linkages with the rest of the economy and investments in housing have orchestrated impact in the region and on the broader economy. Housing initiatives must be viewed in the background of the overall economic development and the needs of the people. According to the NSSO Report, about 66% financing of new constructions in the last one year was done by families with their own resources; about 27% constructions had some amount financed from non-banking agencies such as money lenders, NBFCs, family and friends while 9% of new constructions were financed by institutional channels such as government
schemes, banks etc. Hence, it revealed that the non-banking institutional agencies are playing significant role in housing finance. Due to their financial assistance on the one hand, they are enhancing housing in society and on the other, due to their attractive schemes in housing, they are earning profits. The profit helps them by further growth. There are many NBFCs in housing finance. It is essential to compare their performance so as to get the overall growth of these NBFCs. In this regard, the present study is proved as useful and significant.

1.3 NEED OF THE STUDY

The following reasons have made us to work on the topic of Performance Evaluation of Non Banking Financial Companies in India (A Comparative Study) that reviewing existing literature anvils the fact that:

1. No research is under taken especially for Non Banking Housing Financial Companies in India for Performance analysis in term of risk, return, growth and value respectively.

2. The methodology that, the present study proposed for the work is not adopted so for in any study.

3. Especially after Liberalization, Privatization, Globalization no study is attempted measuring performance on Housing Finance Companies. Hence there arise needs for the present study.
1.4 SCOPE OF THE STUDY

The present study expected to produce some important findings and conclusions/recommendations which may help the housing finance companies to formulate policies and programmes to manage minimization of risk & maximization of profit & value creation of Non-banking housing financial companies effectively. This will go in the improvement of better performance in the market.

1.5 STATEMENT OF THE PROBLEM:

As discussed above, the NBFCs in different areas in general and in housing finance are playing significant role in society and also profitable to investors. Due to competition between these institutions, the customers are getting diverse housing finance schemes and attractive rates of interests; thereby these NBFCs are also growing in terms of investment, deposits, loans, profits, etc. Hence, the present study is made to evaluate the performance of NBFCs in housing sector under the title Performance Evaluation of Non-Banking Financial Companies in India (A Comparative Study of Select Companies).
1.6 OBJECTIVES OF THE STUDY:

The following Objectives have been set for the present study.

1. To know the performance of select Non-Banking Housing Financial companies in India in terms of profit & growth.

2. To identify the Operating Risk, Financial Risk, Business Risk & along with the return of respective companies.

3. To understand the Return Per Unit of Risk (RPUR) of Select Non Banking Housing Financial companies in India.

4. To ascertain the sustainable growth rate of earnings for the Non-Banking Financial Companies.

5. To find the Economic Value Added (EVA) of the Non Banking Housing Financial Companies.

6. To know the Composite Index Value for better performance of Non Banking Financial companies in India.

7. To offer suggestions in the light of findings for select Non-Banking Housing Financial companies.

1.7 METHODOLOGY OF THE STUDY

Research in common jargon refers to a search for knowledge. The purpose of research is to inform action it is a process of collecting, analyzing and interpreting information to answers to questions. Research includes any gathering of data, information and facts for the advancement of knowledge.
The present study has also been initiated with the basic objective to evaluate the performance of housing finance companies (NBHFCs). In order to achieve the objectives of the study, the following research methodology was used:

The present study sought to analyze and rank companies based on the following parameters.

- Risk
- Return
- Safety
- Growth
- Wealth creation

After having laid out the data according to the various above parameters, although all the parameter described above play an important role a company to excel, they differ in importance of the quantum. We have carefully measured this requirement and we assigned 33 percent weights to (equal importance) Return Per Unit of Risk (RPUR), Growth and Value respectively. Finally composite index is computed and analysis is undertaken for the performance evaluation of select companies.
SAMPLE SELECTION:

The whole Indian Non-Banking Housing Financial Companies serves the population for the study. For the present study, only five profit making stock market listed Indian Companies were selected. They are as under.

1. Dewan Housing Finance Ltd. (DHFL).
2. GIC Housing Finance Ltd. (GICHFL).
3. Gruh Housing Finance Ltd.
4. Housing Development Finance Corporation Ltd. (HDFC).
5. LIC Housing Finance Ltd. (LICHFL).

DATA COLLECTION:

This study conceptually covers a period of ten years starting from 2004-05 to 2013-14 the present study based on secondary data, the data has been gathered from various sources such as published books, journals, magazines, newspapers, websites and past records governments, private organization involved in housing finance operations as well as regulations. And also the data collected from RBI Bulletins also form part of the secondary data.
1.8 LIMITATIONS OF THE STUDY:

The present study suffers from the following limitations.

As reported by RBI, there were total 13014 NBFCs in India and 428 NBFCs accepting public deposits in India registered with RBI in 2006. All these NBFCs are specialized in different areas of financial assistance. Further it is difficult to identify the NBFCs that are specialized in housing finance. There are top five NBFCs in housing finance in India, namely, Dewan Housing Finance, GIC Housing Finance, Gurh Housing Finance HDFC Housing Finance and LIC Housing finance. Hence, the present study analyzed the performance evaluation of these five NBFCs only. The present study some of the limitations as under:

1. No primary source of information is used to reinforce the truth of findings got through the secondary information.

2. Valuation of growth is available only for listed companies but not for unlisted companies, as there is no availability of P/E ratios.

3. Loss making firms are out of the purview of this present study.

4. Returns to investors depend upon so many other variables not just on growth & dividends. Put differently, the market values of Non-banking Housing Financial Companies do not depend only on growth and dividends but also on other variables like risk, quality of management etc.

5. Findings of the study can be validated by conducting similar study on other companies of different industries.
6. Non-Banking Financial Companies consists of investment & holding companies, leasing companies, Housing Finance companies etc. For the present study, only Non-Banking Housing Financial Companies were considered.

7. Researcher used accounting information of select companies in terms of number of ratios on the presumption that all Housing Financial companies have used similar Accounting Policies.

8. Findings & Conclusion provided here are subjective in character.

1.9 **ORGANIZATION OF THE STUDY**

The present study entitled Performance Evaluation of non banking financial companies in India (A comparative study of select companies) has been organized into seven chapters.

The first chapter makes an attempt to provide introduction and design of the study comprising Introduction, need and scope of the study, statement of the problem, objectives of the study, methodology followed, period of the study, limitation of the study and chapter scheme.

The second chapter deals with the `Review of Literature`, which discussed about literature survey conducted.

The third chapter deals with the Growth and Development of NBFCs in India. Further to understand growth & significant role in Indian economic system.
Fourth Chapter is used to bring clear understanding of Regulatory framework of NBFC’s in India, other aspects of regulations & supervision, registration requirement of NBFC’s, amendment to RBI Act & New regulatory frame work & Salient feature of the RBI regulatory frame work has been under taken.

Fifth Chapter Provides a Profile of Non Banking Housing Financial Companies of Selected companies dealt in this chapter.

The sixth chapter constitutes an analysis of Performance evaluation of select Non Banking Housing Financial companies in India is provided in Sixth Chapter.

The concluding chapter portrays the key findings of the study based on the analysis of the previous chapter and offer some valuable suggestions for overall improvement of select Non Banking Housing Financial Companies along with conclusion. And also Scope for further research is the subject matter of Seventh chapter which is concluding and final in nature.

Besides the above chapters, a list of the research papers, articles, books, research reports and web sites referred are provided under the title “Bibliography” as the research report.
REFERENCES:


