Chapter 3

Role of NBFCs in the Financial System, its Present Scenario and Receivable Management
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The financial system of India comprises various institutions engaged in the financial market of the country’s economy. These institutions include all India level financial institutions like IFCI, IDBI, NABARD, SIDBI, NHB and others. The investment institutions including UTI, LIC, GIC and State level financial institutions like SFC, SIDCO, etc. and the Commercial Banks, Co-operative banks, Mutual funds, the new generation private sector insurance companies both in Life insurance and General insurance and the Non Banking Financial Institutions, Chit funds, Housing finance companies, etc. form part of financial system of the country. In addition to the above, there are various intermediaries operating in the Capital and money market which also form an integral part of the financial system. Thus the financial system is closely interwoven with various financial subsystems in which Non Banking Finance Companies do play important role and have a significant position.

3.1 Instalment Credit

In olden days, finance companies were set up to provide credit to households or firms, usually to finance the purchase of appliances or equipment. The first known example is in the United States, of a retailer providing instalment credit to its customers was the New York furniture company of Cowperwait and Sons, which began this practice in 1807 (Khan, 1997). The practice soon spread throughout the furniture business. It was later taken up by the manufacturers of
the major household appliances like sewing machines and pianos of the
nineteenth century (Singer began offering instalment credit in 1850).

However, instalment credit really took off only with the beginning of the mass
marketing of automobile from 1915 (Khan, 1977). Automobile companies set up
specialized subsidiaries called finance companies to provide instalment credit to
car buyers and to finance the inventories of dealers and suppliers. The
automobile companies were soon followed by retailers and manufacturers of
consumer durables and producer durables. The ideas spread from the United
States to many other countries.

Globally, finance companies have competed successfully with banks when they
have chosen automobile loans and equipment leasing. Finance companies were
better at this than banks (Khan, 1997). They were often subsidiaries of
manufacturers of equipments or vehicles which gave them informational
advantage. Even if they were not associated with manufacturers, specialisation
has allowed them to acquire a great deal of experience. In 1970, 80s and early
90s, many finance companies expanded their activities beyond their area of
expertise. One of the important reasons was their desire for diversification.

3.2 Evolution of the Growth of NBFCs

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 is a stage in the evolutionary
process wherein the growth of NBFCs is more pronounced than other
components of the financial system. Further, they take different forms and sizes
depending upon the needs of their clients. Thus, in the United States of America, the growth of NBFCs were more pronounced during the first three decades of the 20th century and two of the top five commercial lenders were NBFCs and three of the four top providers of consortium finance are non bank firms (Pahwa and Pahwa, 1998). In India, such marked growth in the non bank financial sector was noticed during the last two decades of the 20th century. The NBFIs, as a group, have succeeded in broadening the range of financial services rendered to the public during that period.

Initially intended to cater to the needs of the savers and investors, NBFCs later on developed into institutions that can provide services similar to those of banks. In India, several factors have contributed to the growth of NBFCs. They provided tailor-made services to their clients. Comprehensive regulation of the banking system and absence of relatively lower degree of regulation over NBFCs has been one of the main reasons for the unprecedented growth momentum of the latter (Shekhar and Shekhar, 1998). Further, their higher level of customer orientation in as much as lesser pre and post sanction requirements, simplicity and speed of their services has attracted customers to these companies. The monetary and credit policy followed by the country has left a section of the borrowers outside the purview of the commercial banks and NBFCs catered to the needs of this section. Further, the marginally higher rates of interest on deposits offered by the NBFCs have also attracted towards them a large number of small savers.

In many countries, NBFCs have been able to serve the household, farm and small enterprise sectors on a sustained basis. However, regulation of their activities was found unwarranted since their operations were limited and they were not in a position to create money, like the commercial banks. It was Gurley
and Shaw (1960), for the first time, established that the NBFCs compete with the monetary system and there is a need to regulate them. Of late, the vast size of these institutions, both in terms of number of units and depositors, has made it impossible to ignore them.

3.3 Recognition for the growth of NBFCs

There was thus a growing realization among the monetary authorities that there was the need to link financial institutions to the formal financial system with a view to ensuring a competitive environment. It had also been revealed that economic development and growth of NBFCs are positively correlated (Vasanth Desai, 2001). In this regard, the World Development Report (1989) has observed that banks in developing countries hold a bigger share of all financial assets (48 percent) than they do in industrialised countries (37 percent). In contrast, non bank intermediaries and contractual savings institutions (i.e., life insurance and pension funds) hold a much larger share of financial assets in high income countries than they do in developing ones (Pahwa and Pahwa, 1998).

As the demand for financial services grow, countries need to encourage the development of NBFCs and securities markets in order to broaden the range of services and to stimulate competition and efficiency. Some countries have already made considerable progress towards more diversified financial system. Among developing countries, Brazil, India, Jordan, Korea and Malaysia are having a large non bank financial sector.

3.4 Financial Services Industry in India

Indian financial sector consists of three major entities (Ravichandran, 1999):

(a) Development Banking Institutions
(b) Banking Institutions

(c) Non Banking Financial Intermediaries: A major component of NBIs is Non Banking Financial Companies.

Thus Non Banking Financial Companies are an important part of the financial system in their role as financial intermediaries. There are considerable similarities between commercial banks and Non Banking Financial Companies. Both offer many common services and are competing with each other in certain segments. The distinction between banks and NBFCs is fast blurring. The chief distinction that still remains is that banks perform the function of liquidity creation whereas NBFCs do not.

In a way, it can be said that NBFCs are doing business akin to that of banks and the other differences between banks and NBFCs are as follows (www.rbi.org.in).

a) NBFCs cannot accept Demand Deposits.

b) NBFCs 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 NBFC deposits like in case of banks.

3.5 Evolution of NBFCs in India

Initially NBFCs 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 NBFCs 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).

With the introduction of economic reforms and abolition of the Controller of Capital Issues regime and the allowing of free pricing of public offers, there was a boom in the financial services sector (Ravichandran, 1999). As more companies needed to tap the capital market, NBFCs also entered into merchant banking. Investment banking was the next logical step. Merchant banking involves a wide range of activities most of which are non fund based. Merchant banking is generally international in nature, and financial services and advice are generally offered for a fee. Thus, NBFCs branched out from fund-based activities to fee-based activities.

The situation was that with the huge demand and the low entry barriers, many could start and own financial service companies during that period. Finance could be accessed from capital markets without any need for an established track record. Thus, it was possible for many fly-by-night companies to just advertise for and start accepting deposits, without being subjected to any kind of appraisal.

These companies got their business from corporates which did not have market standing and could not access funds from banks. Despite the high cost of funds, they preferred borrowing from NBFCs because only few questions were asked, service was speedy and there was great flexibility in structuring the repayments. Thus, NBFCs could command high premiums and grew at a frantic pace. The total number of NBFCs in India, as of 1998 was estimated to be around 45000 and in order to get high returns, a riskier portfolio of assets were maintained by
them, which increased the depositors’ risk in the long run (Ravichandran, 1999). Moreover, the low ratio between paid up capital and deposits and the lack of deposit insurance made it even riskier proposition.

The fact that NBFCs have also grown along with banks and financial institutions, reflect the preference of some investors who prefer to make a more risky investment in NBFCs with higher return expectation.

3.6 Factors Leading to NBFC Proliferation

The factors leading to NBFC proliferation can be broadly classified into asset-side and liability-side factors. The liability-side factors deal with the depositors who lend money to the NBFCs while the asset-side factors concern the consumers to whom the NBFCs lend money.

The asset-side factors include the provision of tailor-made services to clients, a high level of customer-orientation, simplicity and speed of transactions. Combined with these factors are the low degree of control and regulation and fewer pre and post sanction requirements resulting in less hassle for the customer. All these factors contributed to the faster momentum of growth for NBFCs (Ravichandran, 1999).

On the liability-side, the higher rates of interest offered by NBFCs resulted in some flow from the banking sector to NBFCs. This included small savers who were attracted by rates of return that were above average. To the extent that the high interest rates offered by NBFCs resulted in transfer of funds from dormant currency holdings to NBFC deposits, thus NBFCs have played a major role in
increasing the degree of financialisation of savings through widening of the resource base (Ravichandran, 1999).

3.7 Activities of NBFCs

Activities of NBFCs can be classified into two main categories (Verma, 1997):

1. Fund based activities
2. Fee based activities (Consulting services)

We shall be concentrating our study on the fund based activities of NBFCs as the relevance of receivable is applicable to fund based activities, that is asset based financing.

In India, the last decade of the 20th century has witnessed a phenomenal increase in the number of NBFCs. The number of such companies which stood at 7063 in 1981, increased to 37880 by 1994 (Khanna Committee Report, 1996). Simultaneously deposits with NBFCs have increased despite the fact that there are quite a few advantages attached to interest-earning bank deposits, such as, the deposit insurance cover, cheque facilities for saving bank deposits and tax concessions in respect of interest earned (Repealed Section 80L of the Income Tax Act, 1961). The main reasons for growth of deposits with NBFCs were the greater customer orientation and higher rate of interest offered by them as compared to banks. A depositor is primarily concerned with liquidity, safety and yield on deposits. As far as liquidity is concerned, term deposits with banks and deposits with the NBFCs are more or less at par. As regards safety, there does not seem to be sufficient awareness of the risks a depositor runs in placing his funds with NBFCs whose activities are not sufficiently regulated or supervised. Investment decision by a depositor is largely guided by the yield on his investment. This is more so under conditions of high inflationary pressures. In
order to maintain real value of his savings, a depositor might be willing to place his funds with some risk. Further, the NBFCs were in a position to pay higher interest to their depositors, since many of them were able to deploy their resources in segments where there are credit gaps at rates higher than those charged by banks (Verma, 1997).

With this background, during 1980s, NBFCs had high growth especially when there were no regulatory restrictions and entry barriers. Any one who desired of owning a finance company could do so. During that period, they could incorporate a company with Registrar of Companies with out knowing about it by RBI or even didn’t have to report to them. This scenario has resulted in the mushroom growth of NBFCs. Both Government and RBI were concerned about this frantic growth of NBFCs at that time especially with regard to safeguarding the interest of depositors.

Many of the developed and developing countries did not permit NBFCs to access public deposits, however in India it was permitted as well it did not have proper regulatory controls. All these resulted in the need for NBFC regulations.

3.8 Need for NBFC Regulation and Appointment of Various Committees

NBFCs have been operating for quite a long time. However, an attempt to regulate them started only in the sixties. Regulation of these institutions were found necessary for the following three reasons, viz.,

(i) ensuring efficacy of credit and monetary policy
(ii) safeguarding depositors' interest, and
(iii) ensuring healthy growth of NBFCs.
In recognition of the fact that NBFCs are an integral part of the money market and for the efficient working of the financial system all parts of the system needed to be integrated and regulated. It is against this background that from time to time various study groups have been appointed by the Government of India and RBI for examining the role and regulatory framework of NBFCs.

Both Government of India and RBI were concerned with the frantic growth of NBFCs in terms of their number and in terms of growth of deposits held by these companies. During that time, there was hardly any regulatory framework other than that of the Non Banking Financial Companies (Reserve Bank Directions, 1977). These directions proved to be insufficient in regulating the functioning of the NBFCs and many committees were set up to suggest ways and means to improve the regulatory framework. The recommendations of various committees reveal that all of them recognized the importance of the role of NBFCs and emphasize the need for a well established and healthy non banking financial sector. The regulatory system needs to be under constant review in view of the dynamic changes that are taking place in financial services sector so as to ensure a healthy growth of the non banking financial sector.

In January 1997, an Ordinance was issued by the Government of India effecting comprehensive changes in the provisions of the RBI Act, 1934. This was subsequently replaced by the Reserve Bank of India (Amendment) Act in March 1997. The salient features of the amended provisions, based on the recommendations of the Shah Committee, pertains to the entry point norm of Rs.25 lakh as minimum Net Owned Fund (NOF), (which was subsequently raised to Rs.2 crore by the Reserve Bank), compulsory registration with the Bank, maintenance of certain percentage of liquid assets in the form of
unencumbered approved securities, creation of reserve fund and transfer thereto every year an amount not less than 20 percent of net profit, determination of policy and issuing of directions by the Bank on prudential norms, prohibition of NBFCs from accepting deposits and filing of winding-up petitions for violation of directions. The Company Law Board was empowered to direct a defaulting NBFC to repay any deposits. Stringent penal provisions were also included empowering the Reserve Bank to impose, *inter alia*, pecuniary penalty for violation of the provisions of RBI Act.

The situation till the end of 1997 was that the eligible companies (Registered, rated and complying with the prudential norms) were given freedom to determine their own rate of interest on deposits, accept unrestricted/increased amount of deposits and to maintain lower level of liquid assets. Some of the companies were holding deposit even more than 10 times of their Net Owned Funds as well as many of the NBFCs have increased their deposit rate even up to 20 percent during 1996 and 1997 (Verma, 1997). It was at this point of time that the RBI has come out with stringent norms, ie., the Non Banking Financial Companies Prudential Norms (Reserve Bank Directions 1998 by Notification no. DFC 115/DG(SPT) 193 dated January 2, 1998).

3.9 Post 1998 Developments and Regulatory Frameworks

The RBI announced a host of stringent regulatory measures on 2\(^{nd}\) January 1998. They are related to restrictions on acceptance of deposits from the public, categorization of NBFCs, classification norms for Hire purchase and Leasing companies, compulsory credit rating for a company to accept public deposits, imposition of ceiling on rate of interest on deposits and directions to statutory auditors. These measures created a lot of confusion, fear and despair not only to
the NBFCs but also to the depositors of NBFCs. This resulted in the public outcry and representation by various associations of industry to both Government of India and RBI. Almost all financial publications, economists, eminent personalities from within and outside the industry and associations of NBFCs have commented on it in various articles.

From the pre 1998 deregulation on deposit acceptance both in terms of quantum and rate of interest- the January 1998 prudential norms and subsequent developments totally changed the position of NBFC from a no regulation to an over regulation situation. Major emphasis was to arrest the mushroom growth of number of NBFCs and the quantum of public deposit accepted by them. The access to public deposits by NBFCs has been linked to adherence of prudential norms and it has been made compulsory the registration of NBFCs. Access to public deposits has almost been restricted to Asset Finance Companies which were earlier known as Hire purchase Finance Companies and Equipment Leasing Finance Companies. These two groups of companies has been renamed and regrouped into a single one, ie., Asset Finance Companies (NBFC-AFC-D) [D for Deposit taking and ND for Non Deposit taking] by retaining all other regulatory norms and conditions (RBI, 2006).

3.9.1 Deposit Acceptance

Most important conditions among others to be fulfilled to have public deposit by an NBFC is as follows:

1. Certificate of Registration (Since 8 July 1997 it is mandatory that all NBFCs should be registered with RBI and should have a Certificate of Registration)
2. Adherence to the prudential norms

3. Should have a minimum of Investment grade rating from an approved rating agency.

RBI has also linked the quantum of access to public deposits to Net Owned Funds of the company and maximum limited to that of four times of NOF and subject to fulfilment of various conditions and on maintaining a CRAR of 12 percent for NBFC-AFC-D.

A NBFC maintaining required NOF/CRAR and complying with the prudential norms can accept public deposits as follows:

<table>
<thead>
<tr>
<th>Category of NBFC</th>
<th>Ceiling on Public Deposits</th>
</tr>
</thead>
<tbody>
<tr>
<td>EL/HP Companies maintaining CRAR of 15 percent without credit rating</td>
<td>1.5 times of NOF or Rs 10 crore whichever is less</td>
</tr>
<tr>
<td>EL/HP Companies with CRAR of 12 percent and having minimum investment grade credit rating</td>
<td>4 times of NOF</td>
</tr>
<tr>
<td>LC/IC with CRAR of 15 percent and having minimum investment grade credit rating</td>
<td>1.5 times of NOF</td>
</tr>
</tbody>
</table>

Source [http://www.rbi.org.in](http://www.rbi.org.in)

*This has further been amended by RBI in June 2008*

For Loan and Investment companies access to public deposits has been limited to 1.5 percent of the NOF provided that they have a minimum of investment grade rating and a CRAR of 15 percent. Table 3.1 shows the type of NBFCs which can have access to public deposits and certain condition to be fulfilled for the acceptance of such deposits.

From 2\textsuperscript{nd} January 1998, whole of the regulatory emphasis has shifted to asset side of the Balance sheet of the NBFCs with the primary aim of protecting the
interest of the depositors. It is also seen that to have access to public deposits NBFCs should have credit rating assigned by one of the recognized rating agencies. Rating is assigned by the rating companies mainly by assessing the quality of assets i.e., by evaluating the capacity to repay the deposit of NBFCs. Non Performing Assets, Asset-Liability Management and various other factors are analysed by rating agencies before assigning the rating. From this it is very clear that to survive in the asset financing business NBFCs need to concentrate on this asset quickly. Asset quality can be improved by vigorous screening at the time of granting loan, which is not practical on NBFCs both because of heavy competition as well as their increased rate of interest. So the answer is properly managing the receivables.

Due to the nature of business and their activities, some of the non banking finance companies are kept outside the purview of the RBI regulation and registration. Many of such companies are not permitted to have access to public deposits and are regulated by some other statutory authorities like, IRDA, SEBI, NHB and others.

Types of NBFCs which are regulated by RBI are as follows.

1. Asset Finance Companies (HP and Lease)
2. Investment Companies
3. Loan Companies and
4. RNBFCs.

Residuary Non Banking Finance Company (RNBFC) is a class of NBFC which is a Finance Company and has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner and not being Investment, Leasing/Hire purchase (Asset Financing), Loan Companies. These
companies are required to maintain investments as per the directions of RBI
(mainly in government securities) in addition to liquid assets. The functioning of
these companies is different from those of other NBFCs in terms of method of
deposit and requirement of deployment of depositors' funds. (Hence we shall not
include RNBFC within the purview of our studies of Receivable Management as
it is not likely to have receivable issues, investments mainly being in guilt-edged
funds). The latest news on RNBFC is on the baring of deposit acceptance of
Sahara India Financial Corporation Ltd. by RBI, its stay by Supreme Court and
subsequent modification of order by RBI (Business Line, 2008).

The loan companies and investment companies do not have access to public
deposit (except that if they hold a minimum of investment grade credit rating and
have CRAR of 15 percent, they can accept deposit to the extent of 1.5 times of
NOF) and in the light of the above we shall also exclude Loan companies and
Investment companies from the purview of our studies.

To have a greater control on large NBFCs which are not deposit accepting
companies, mainly operating either as investment companies or loan companies
and have an asset base of Rs. 100 crore or above are classified as
systematically important NBFCs. NBFC-ND-SI denoting non deposit taking
systematically important non banking finance companies. Such companies are
also required to provide additional information to RBI in comparison to those loan
and investment companies whose asset base is less than 100 crores
(www.rbi.org.in).

It is clear from the RBI guidelines, registration norms and permission for public
deposit acceptance, the most important among NBFCs are the Hire Purchase
Finance Companies and Equipment Leasing Companies which have been reclassified as Asset Finance Companies. Accordingly our study on Receivable management is extended to Asset Financing Companies that too specifically on vehicle financing company. Before going into the details of the analysis on subsequent two chapters, we shall see certain trend and analyse them with respect to pre 1997-98 and post 1997-98 developments (prior to compulsory registration from 8\textsuperscript{th} July 1997 and after introduction of prudential norms on 2\textsuperscript{nd} January 1998). These companies are named/classified as NBFC-AFC-D denoting Non Banking Finance Companies which are on Asset financing as well Deposit accepting companies.

Secondary data are collected from various sources especially that from RBI Trend and Analysis of various years. Its analytical reports are as follows:

3.10 Introduction to the State of Affairs of NBFC

The number of NBFCs and their deposits are taken for the period from 1971 to 2007 from various reported sources. However, the advances, arrears and NPAs figures are not available for the period from 1971 to 1997 due to the then existed reporting pattern. Hence the analysis of the trend for the period from 1971 to 1997 is limited to the existence of number of NBFCs, their deposits and its growth.

Figure 3.1 and table 3.2 shows the growth of deposit of NBFCs from 1971 to 1997 i.e., from a meager 41.9 crore in 1971 to 53116.0 crore in 1997. This was the period where there was no entry barrier or regulatory restrictions for the growth of NBFCs. NBFCs frantically grew without any control and were having access to public deposit without any regulatory control. This mushroom growth
in number of NBFCs and deposit held by them has caught the attention of both Government of India and RBI.

Fig. 3.1 Aggregate Deposits of NBFCs from 1971 to 1997

Data source: Handbook of Statistics on Indian Economy, Reserve Bank of India. 1999

<table>
<thead>
<tr>
<th>Year</th>
<th>Deposit</th>
<th>Year</th>
<th>Deposit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1971</td>
<td>41.90</td>
<td>1985</td>
<td>409.50</td>
</tr>
<tr>
<td>72</td>
<td>64.70</td>
<td>86</td>
<td>485.50</td>
</tr>
<tr>
<td>73</td>
<td>54.30</td>
<td>87</td>
<td>832.30</td>
</tr>
<tr>
<td>74</td>
<td>80.00</td>
<td>88</td>
<td>1136.90</td>
</tr>
<tr>
<td>75</td>
<td>104.70</td>
<td>89</td>
<td>1505.90</td>
</tr>
<tr>
<td>76</td>
<td>128.70</td>
<td>90</td>
<td>1773.40</td>
</tr>
<tr>
<td>77</td>
<td>147.30</td>
<td>91</td>
<td>2024.70</td>
</tr>
<tr>
<td>78</td>
<td>185.10</td>
<td>92</td>
<td>2824.10</td>
</tr>
<tr>
<td>79</td>
<td>155.60</td>
<td>93</td>
<td>4287.80</td>
</tr>
<tr>
<td>80</td>
<td>187.80</td>
<td>94</td>
<td>17389.50</td>
</tr>
<tr>
<td>81</td>
<td>215.00</td>
<td>95</td>
<td>25440.50</td>
</tr>
<tr>
<td>82</td>
<td>214.00</td>
<td>96</td>
<td>38710.60</td>
</tr>
<tr>
<td>83</td>
<td>237.30</td>
<td>1997</td>
<td>53116.00</td>
</tr>
<tr>
<td>1984</td>
<td>275.60</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Handbook of Statistics on Indian Economy, Reserve Bank of India. 1999
Figure 3.2 shows the total number of NBFCs registered with RBI including that of deposit taking NBFCs declined from 14077 in June 2002 to 11642 in March 2008. Similarly, figure 3.3 shows the number of deposit taking NBFCs declined from 784 in June 2002 to 376 in March 2008. This decline was mainly due to the exit of many NBFCs from deposit taking activity as well as exit of many of the NBFC from non financing activities to mere non banking activities. The trend also shows that the regulatory restrictions mainly that of prudential norms, the entry barriers like compulsory registration, minimum requirement of Rs. 2 crore net owned fund, etc. has resulted in this decline. The trend also shows that total number of NBFCs is continuing to fall and it is to be seen as to what extend the fall of NBFC shall negatively contribute to the financial system and economy of the country.

* Fig. 3.2 Number of NBFC Deposit Taking and Total NBFC/10 from 1999 to 2008*

* Report on Trend and Progress of Banking in India, Various Issues, 2001-02 to 2006-07, RBI
* Business Line 18.4.2008
Figure 3.4 shows the deposit held by deposit taking NBFC from 1998 to 2007 and had a drastic fall from 13571 in 1998 to 2042 in 2007. An annual fall of 27.9 percent in 1999 and 23.43 percent in 2007. This is due to both fall in number of deposit taking companies as well as due to the quantum of deposit held by such companies. From the trend it is seen that both number of deposits taking NBFCs as well as the deposit held by them are falling year after year. Probably the regulators intention is to take away the NBFCs from their access to public deposit as happening in many of the foreign countries (An article appeared in Business Line dated 18.4.2008 entitled “only banks may be permitted to accept public deposits” amply speaks in favour of above trend. The said article was based on the comment made by Shri. V. Leeladhar, Deputy Governor of RBI on 17th April 2008 at Mumbai “ It is time to think of allowing only banks to accept public deposits……. If it comes true, how far NBFC can discharge their role of retail financing and contribute to the national economy is a subject of discussion and debate in both academic and industry circle. Another interesting article by Krishnamurthy (2004) elaborates on the point and highlights on the problems, if NBFCs are phased out of deposit acceptance).
Figure 3.5 shows the share of public deposits in NBFCs to that of scheduled commercial banks in percentage terms for the period 2003 to 2007. This indicates that not only the quantum of deposit but also their ratio with respect to scheduled commercial bank is falling. The share of deposit held by NBFCs was 3.1 percent in 1980-81 and 10.6 percent in 1995-96 with that of scheduled commercial banks which fell drastically in 2002-03 to 1.5 percent and 0.95 percent in 2006-07.
Figure 3.6 also shows the spread in deposit interest rate of banks and NBFCs and its comparisons. It could be seen that in 2007 the spread has come down below 2 percent and the narrowing down on the interest rate between banking and non banking finance companies shall further reduce the total deposit held by NBFC as well reduce their share of deposits in comparison to scheduled commercial banks. Reasons for narrowing down the spread are the regulatory restrictions and more than that the market compulsions [banking deposit interest rates are not regulated (no upper ceiling as of now) whereas NBFC deposit rates are regulated by RBI]. The situation is that virtually NBFCs are not in a position to offer the RBI permitted upper ceiling rate of 12.5 percent on their deposits due to their increasing cost of funds and market compulsions and now many NBFCs are operating far below the upper ceiling.

Source: Report on Trend and Progress of Banking in India, 2006-07; RBI
* Source: http://www.rbi.org.in
3.11 Non Performing Assets of NBFCs

The reported figures on NPAs for the period from March 1998 to March 2007 show a very glossy picture. The highest net NPA seen is in the year 2000 and thereafter it has fallen substantially. This indicates that efforts of NBFCs were in bringing down the NPA, which is an important component of total arrears. The provisioning and write off norms spelled in the prudential norms were based on the number of instalments in default in the NPA category. As NPAs are derived out of the total arrears, there need to be more concentration on managing the entire receivables as NPAs alone cannot be just like that controlled, if arrears/receivables are not well managed from the time of granting the loan.

<table>
<thead>
<tr>
<th>As at End of Period</th>
<th>Gross NPAs</th>
<th>Net NPAs</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 1998</td>
<td>11.4</td>
<td>6.7</td>
</tr>
<tr>
<td>March 1999</td>
<td>10.2</td>
<td>7</td>
</tr>
<tr>
<td>March 2000</td>
<td>9.9</td>
<td>9.5</td>
</tr>
<tr>
<td>March 2001</td>
<td>11.5</td>
<td>5.6</td>
</tr>
<tr>
<td>March 2002</td>
<td>10.6</td>
<td>3.9</td>
</tr>
<tr>
<td>March 2003</td>
<td>8.8</td>
<td>2.7</td>
</tr>
<tr>
<td>March 2004</td>
<td>8.2</td>
<td>2.4</td>
</tr>
<tr>
<td>March 2005</td>
<td>5.7</td>
<td>2.5</td>
</tr>
<tr>
<td>March 2006</td>
<td>3.6</td>
<td>0.5</td>
</tr>
<tr>
<td>March 2007</td>
<td>1.9</td>
<td>0.4</td>
</tr>
</tbody>
</table>

*Source: Report on Trend and Progress of Banking in India, Various Issues, RBI*
Table 3.3 shows the non-performing assets of the deposit accepting NBFCs. Figure 3.7 represents both gross and net NPA and it is interesting that net NPA of such NBFCs have drastically come down to 9.5 percent in 1998 to 0.4 percent in 2007 of net assets outstanding. Reduction in NPA is highly essential for the stable health of asset financing NBFCs and that has happened here. It is a matter of concern whether the fall in number of NBFCs is a contributor to the fall in NPA or vice-versa. It is also a factor to be analysed whether the entire system is concentrating on reduction of NPA to get better rating, to project a better picture to the regulator RBI, rating agencies and all other stakeholders, by accounting juggleries, higher percentage of write-offs and concessional settlement, rescheduling and many more of such tactics. It is also worth to analyse the total outstanding arrears and write-offs of each year to get a better picture from the receivable position of the NBFCs (Such figures are not available even in the RBI Trend and Analysis).

Table 3.4 represents the financial performance of NBFC-D as at the end of March 2006 and 2007 and its comparison.
From the above statistics, it is evident that number of NBFCs especially NBFC (AFC-D) and their deposit are coming down on an alarming rate. Item G financial ratios show a true comparison on the performance of the years 2005-06 and 2006-07. It is already seen that deposits held by this category of NBFCs are falling down year after year. In spite of that, total asset of the NBFC-D has
increased in the year 2007 i.e., due to the increased borrowing by NBFCs- a deviation from the deposit acceptance. It could further be seen that as a percentage of total asset following ratios have fallen. Income has fallen from 12.2 percent to 12.0 percent; fund income from 11.8 percent to 11.7 percent; net profit has come down from 1.5 percent to 1.2 percent. Similarly, it is seen that expenditure has gone up from 9.9 percent to 10.0 percent; financial expenditure from 5.7 percent to 5.8 percent and operating expenditure from 2.5 percent to 2.6 percent. While income as a percentage of asset declined marginally, expenditure (including provisions) as percentage of asset increased marginally, resulting in a decline in the net profit to asset ratio. This also indicates that provisioning and write off have substantially increased in NBFCs with an aim to bring down the non performing assets. Bringing down the NPA by higher write off and provisioning shows a healthy picture on financial indicators of the company but clearly bringing down the net profit. This indicates the necessity for the importance and need for better management of receivables in NBFCs whereby write off, provisioning, total arrears and non performing assets can be reduced with an increased profit of margin. This will also result in increase in net profit as a percentage to total asset, whereby there could be healthy growth for the segment of financial institutions.