Chapter 2

Review of Literature
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2.1 Introduction

The perfect financial storm now churning its way around the world has even the best finance companies in its grip. Dominion Finance Holdings rocked the market by announcing it was running out of cash and had stopped repaying deposit investors as their investments fell due. The listed property financier, which operates two arms- Dominion Finance Group and North South finance- has proposed a moratorium to give it breathing space to realise loans in an orderly fashion and provide 9020 secured investors the best chance of recovering the $276 million they owe. That announcement was followed by Timaru-based Mascot Finance, which said that it had posted a $7.5 million loss for the year 2008, but was confident of reversing the position during the next 12 months. Both these companies had been considered by analysts to be among the most likely to weather the storm because of sound management, good lending practices and years of experience that goes back several economic cycles. The best companies in the sector can cope up with the strong headwinds created by the international financial crisis, which are now hit from three sides. The credit crunch and slowing property market mean property developers are struggling to sell projects and repay or refinance loans. At the same time, investors reinvest their money and almost no new money comes in.

KPMG’s head of banking and finance, Mr. Godfrey Boyce says that in the case of Dominion Finance, a moratorium is probably the preferable option. “It is a group of companies that we probably wouldn’t have expected to have got caught up in this. But it really is getting into the better quality end now, in terms of the
lower reinvestment rates impacting most of the players in the sector. "If a company can continue to operate and collect its assets in an orderly fashion, it seems a sensible approach to take." The key issue for the sector is the collapse of investor confidence, which has resulted in only about a third reinvesting their money. "Generally what we have seen in the sector is loans are getting repaid, but it is taking longer because the developments have slowed and the market for selling the property into has slowed." Mr. Boyce says the April 2008 collapse of Wellington-based Lombard Finance and Investments marked the beginning of the latest wave of failures. "We are just not sure how big the wash is in terms of how many other people get caught up. One would have to say that there will be two or three more yet in this round. We have seen some big provisioning."

Uncertain times and the global credit crunch is making finance to fund acquisitions hard to come by "The bigger, stronger finance companies seem to have been happy to let others fail, and they get the bigger market share as a result", Mr. Boyce says. "There is absolutely no doubt that poor or mediocre companies might be better to be thinking about closing down, paying everybody off, and going to bed."

The situation in Indian NBFCs is similar or worse as we have seen the failure of many NBFCs mainly due to erroneous lending, receivable problems and regulatory restrictions, especially in post 1997-98 era. To highlight the problem, some of the head lines appeared in the media during that period is reproduced below:

"Manipal group to shut down NBFC arms – Restructuring plans for repayment of deposits" The Manipal group plans to exit non banking finance business by shutting down its three subsidiaries – Maha Rashtra Apex Corporation Ltd
(MRAC), Canara Nidhi Ltd. (CNL) and Manipal Home Finance Ltd. (MHFL). The group has requested the Karnataka High Court to approve its proposed restructuring plans for all the three entities, according to the Vice chairman, MRAC, Mr. Y.V. Pai. "We suffered under a negative U-turn in RBI policies towards NBFCs in 1997," Mr. Pai said. The three companies currently manage public deposits of Rs. 313 crore with a depositor base of 1,75,000.

For MRAC, the restructuring package proposes that interest on all deposits and bonds to be waived with effect from April 1, 2001. Deposits/bonds of Rs. 5000 and less will be repaid in full within 90 days from the 'effective date' or before 31 March, 2003, whichever is later. Effective date means the date on which the order of the high court sanctioning the scheme is filed with the office of the registrar. However, deposits of Rs. 5,000 and above would be returned in three parts: 20 percent of the amount due on 1 April 2001 will be paid in four equal quarterly instalments commencing with the calendar quarter after 90 days from the effective date, 15 percent will be compensated by issue of equity shares of group company Kurlon Ltd. at a value of Rs. 80 per share and the balance 65 percent would be offset by issue of asset recovery bonds. Mattress manufacturer, Kurlon will be listed on the regional stock exchanges of Bangalore and Mangalore, following the issue of equity shares. It is to be noted that both the bourses hardly report any trading, following the ban on short sales and imposition of T+3 regime. The asset recovery bonds will be issued by Maha Rashtra Asset Management Company Ltd. Any amount recovered in excess of the face value of the asset recovery bonds will be distributed as premium on redemption.

For depositors in Canara Nidhi, interest rates on all deposits will be waived with effect from April 1, 2002. Deposits ranging below Rs. 5,000 will be repaid in full within 90 days from the effective date or before March 31, 2003, whichever is
later. While deposits above Rs. 5,000 up to Rs. 10,000 will be repaid in one or more instalments after 1 April 2003 but before 31 March 2004, deposits above Rs. 10,000 will be repaid in one or more instalments from 1 April 2003, but before March 2004, deposits of above Rs. 10,000 will be repaid in one or more instalments from 1 April 2003. This was the aftermath of 1997 regulations and the prudential norms issued for NBFC on second January 1998 by RBI. The story doesn't end there, failure of many of the then leading NBFCs like Mercantile Credit Corporation Ltd. (1997), Integrated Finance Company Limited (2006), etc. are examples of failure of NBFCs and the race goes on.

2.2 Receivables
When University of Rhode Island, USA was faced with the problem of managing receivables, has come out with a receivable management procedure which has great relevance on study of receivable management in NBFCs. The relevant and most important portions are as follows.

I. Guidelines

1. Billing
Prompt billing for the reimbursement of expenses is the single most important factor in managing receivables.

2. Collection of receivables
The Office of Grant and Contract Accounting is primarily responsible for the collection of research receivables. Receivables not collected through standard routine follow up may be referred for collection after approval by the university controller.

3. Ageing analysis
Adequate information concerning the age of outstanding receivables is vital for the proper management, control and reserves for bad debts.
4. Provision for bad debts
In order to properly reflect realized revenues in the university's books, bad debts must also be recognized.

II. Collection
The prompt collection of these receivables is important because they represent substantial amounts of money, therefore, a definite sequence of collection efforts must be followed. Billing records should be checked for accuracy before the outlined collection process begins.

III. Collection Agencies
Before an account (other than federal or state) is referred to a collection agency, a determination should first be made as to whether the amount to be collected exceeds 1000 US dollars and no response has been received by the legal counsel. The office of grant and contract accounting shall submit the account to a collection agency after receiving approval by the university controller (University of Rhode Island, 2005).

University of Rhode Island seems to be quite elaborate and systematic as far as a university is concerned. For the purpose of an NBFC recovery, even though, these procedures are not sufficient enough, it can serve as a good guide line for arriving at a standard recovery procedure.

2.2.1 Accounts Receivable Management Policy
The study by Mian and Smith Jr., (1992) focuses on both cross-sectional explanations of policy-choice determinants, as well as incentives to establish captives. Size, concentration and credit standing of the firm's traded debt and commercial paper are each important in explaining the use of factoring, accounts
receivable secured debt, captive finance subsidiaries, and general corporate credit. Evidence on captive finance subsidiaries, and general corporate credit demonstrates that captive formation allows more flexible financial contracting. However, there is no evidence that captive formation expropriates bondholder wealth.

In NBFCs, factoring by and large are not at all resorted. However, securitization mechanism is resorted in many NBFCs both with and without recourse, for the purposes of increasing the liquidity as well as to get rid of the collection constrains on chronically defaulting accounts.

Accounts receivable (A/R) assets are among the largest and most liquid holdings on the books of most companies. A properly managed A/R portfolio helps expedite cash flow and supports corporate cash requirements. The ultimate goal of A/R management is to increase working capital. The A/R function consists of three principal operations: remittance processing, credit management, and collections. Remittance processing involves payment methods and automated processing. Credit management includes communication of credit policies, credit checks and approvals, and credit maintenance. And collections involve monitoring collection techniques and technology and supervising and motivating internal and external collections agents. Customer service plays a key role in each of these processes. In fact, timely collection of receivable depends a great deal on customer satisfaction, turning it into an effective gauge of the importance A/R places on customer service.

2.2.2 Monitoring Accounts Receivable using Variance Analysis

The study of Gallinger and Ifflander (1986) explains the credit analyst, how to use an accounting-based variance model to evaluate accounts receivable
against budget. Dollar variances between actual and budgeted receivable balances are segregated into a collection experience variance, a sales effect variance, and a joint effect variance. The sales effect variance is further segregated into a sales pattern variance and a sales quantity variance. Knowledge of the contribution of each of these variances to the total variance between actual and budget balances provides insights about accounts receivable that traditional measures, such as day sales outstanding and aging schedules, are unable to reveal.

In every industry, every part of the country and every instance, West Asset Management is responding to the needs of business with innovative recovery solutions that deliver results. As one of the nation's leading receivables management companies, West Asset Management offers a full suite of solutions that are designed to improve operational efficiencies and customer retention, and at the same time reduce expenses and dramatically recover more receivables.

A pioneering application of a Markov chain to forecast account receivable flows employed an unusual (the oldest balance) method of aging accounts and an assumption that the resulting transition matrix was stable. Forecasting steady state results was the primary focus of the application. The present research uses a commonly found (partial balance) method of aging, an assumption of dynamic changes in the transition matrix, and does not focus on steady state results (Winters, 1960; Corcoran, 1978).

Effective management of accounts receivable requires a written procedure manual, so that the patients, the office staff and the doctors understand
everyone's duties and responsibilities. This plan will increase in-house collections (Gross and Romanick, 2008).

An increase in the level of accounts receivables in a firm increases both net working capital and the costs of holding and managing accounts receivables. Both of these decrease the value of the firm, but a liberal policy in accounts receivable coupled with portfolio management approach could increase the value. Efforts to assign ways to manage these risks were also undertaken; among them, special attention was paid to adapting assumptions from value of liquidity theory as well as gauging the potential effect on the firm value (Michalski, 2003).

2.2.3 Automated Receivables Management System

An automated receivable management system provides a self service collection environment using an electronic network, such as the internet or a PCS, a medium for communication and transaction execution. Comprehensive collection services are provided in a fully automated fashion, including account decision, treatment specification, communication channel specification, and communication to the customer and method for payment/response from the customer using the electronic channel. The electronic network operates as a fully automated electronic receivables environment, providing a medium for notification, receiving funds and customer responses, while allowing the creation of a test and control environment for experimentation on a customer level. Using results from existing polices or strategies, the system matches account performance with account history in order to determine the optimal new strategy for interacting with the respective accounts. This process not only determines the optimal strategy, but can automatically apply the strategy to the accounts.
that meets the appropriate criteria. This forms an environment to test new strategies and incorporate new learning in a new strategy creating without human intervention (Campbell, *et al.*, 2006.).

Such fully automated receivable management system is yet to be established in NBFC. Within Indian conditions, partial automation and partial outsourcing through recovery agents are being developed for receivable management in some of the new generation NBFCs. Others continue with the traditional manual recovery method with the support of computer systems.

When a sale is made, an organization receives money. Accounts receivable management encompasses the collection and processing activities of the aforesaid money (Ohio State University, 2008).

Due to the downturn of economy, the bad debt of banks is increasing straightly in these few years. Receivable management becomes an important issue of bank in order to improve full range of business operations. So, the role of receivable management becomes more and more important in this competitive business world (Li and Ling, 2004).

Among the thornier issues that corporate credit and collections professionals face is dispute prevention and resolution. All of which mean delays that can inflate the receivable outstanding (Cummings, 2005).

From the better receivable management angle, the most important aspect for better and timely collection is transparency in dealing and that is more important in NBFC transactions.
In a webcast, the speaker discusses the benefits of automating the account receivable process. The speaker talks about credit management and revenue management in the financial value chain and explains the easy accessibility to market place through financial management. He also induces that the automated account receivable process helps in better managing the receivables.

The range of organizations that leverage the defaulted debt market is growing. The Chief financial officers who want to boost their company's liquidity may be sitting on a potential gold mine in the form of defaulted receivables.

The role of Accounts Receivable departments, and finance as a whole, is rapidly transforming in today's enterprise. Formerly thought of as a purely administrative role, A/R functions extending from credit and collections to cash management are now being viewed as a strategic cornerstone that can deliver unprecedented competitive advantage and greater profitability for leading corporations. The paper depicts a survey the findings of which points out key challenges that confront today in A/R departments.

2.3 Recovery

Recovering the outstanding dues is one of the most important element of working capital management and that can be achieved through better receivable management only.

NASE Member Russell Siegel, an attorney in Fullerton, Calif., says his biggest client insists on being billed only quarterly. Then the client takes another 60 days or more to pay. That habit makes it tough for Siegel, who specializes in workers' compensation cases, to pay his own bills. But he's afraid that vigorous efforts to collect will just drive the client away.
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It's human to feel angry, even betrayed, when a customer doesn't pay, but don't bring those feelings into the collection effort. Gillispie said that he is never rude with anyone, but he is firm. If one come across as hard-nosed, one won't get the money. So play 'up' music on the way to work on the days you have to make collection calls. One has to come across as helping them, as working together to solve this problem.

If the first approach doesn't work, she tries another. One note that she attaches to invoices reads "Good morning. Your account just had a birthday- it's 30 days old." Another offer several choices with a box beside each that the customer checks off (Gillispie, 2006). It is true that the soft way of recovering is necessary for the success of receivable management.

2.3.1 Debt Recovery

This refers to the news item "IBA to enforce fair practice code for debt recovery" (Business Line, 2007). There should definitely be a moral code of conduct for debt recovery but it should not sound as if it is soft on willful defaulters. As it is, the repayment culture is not very good in India. The laws are also heavily loaded in favour of the defaulters. There are very few borrowers who pay up on their own.

Many expect the lenders, especially institutional lenders, to call and tell them that their repayments are due. But the local lenders still use the pressure tactics to recover their dues and they are certainly more successful. The borrowers fear them and are prompt in repaying their dues first.

Mr. Newtown owed two car loan payments and the company repossessed his car. He thought the company had to notify him before that could happen.
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The loan company doesn't have to notify the borrower before repossessing the vehicle. Once the borrower defaults on a loan agreement, the loan company can take action. Companies don't give advance notice because some people try to hide the vehicle. One needs to contact the loan company right away to find out if he can work something out to pay the money owed and get the car back. If he takes no action, the company can sell the vehicle and hold him responsible for the remaining balance. Plus, the repossession company, which is hired by the loan company, will charge a daily storage fee that can add up quickly (The Bucks County Office of Consumer Protection, 2008).

Level of accounts receivables in a firm increases net working capital and costs of holding and managing accounts receivables. Both of them decrease value of the firm but liberal policy in accounts receivables with portfolio management approach could increase it (Michalski, 2007).

Statistics show that assets of over Rs. 4 lakh crore, offered as securities against bank loans have been attached by courts, and are getting destroyed and to nobody’s advantage. This is a problem that needs the urgent attention of the Reserve Bank of India, the Board for Industrial and Financial Reconstruction (BIFR), the debt recovery tribunals (DRTs), judges of civil courts adjudicating bank suits, the various State Government panels studying the problems of sick units and the proposed Assets Reconstruction Company (Joy, 2002).

Many mortgage lenders expected a sub prime meltdown, but not one that came so fast and strong reveals a CNN article as of May 23, 2007. Now they say it's hitting harder and faster than expected— even to those who predicted the crisis in the first place (Kayser, 2007). If the receivable are not better managed similar situation at least for few NBFCs in our country is not too far.
Most people don’t realize exactly how important a good credit score is these days. Everyone needs a good credit score. It’s critical. The credit score is the single largest component, bank and other lending institutions look at when extending credit. The ability to borrow and use other people’s money is absolutely essential. Less than 1 percent of the U.S. population could sustain the lifestyle they live without borrowing money (Shah, 2007).

Even among Indians, habits of borrowing for anything and everything increases day by day. Financiers need to have liberal lending due to competition, but they should have a tighter collection mechanism.

All the Asian countries had weak legal mechanism for asset disposal. This factor prevented early resolution of the problem. This occurs in India too. The defaulters’ fear of legal action is coming down whereby receivable problems are on to increase (Viswanathan, 2002).

2.3.2 Effectiveness of ARCs

Concerns have been raised about the relevance of ARC in India. A significant percentage of the NPAs of the PSB’s are in the priority sector. Loans in rural areas are difficult to collect and banks and NBFCs by virtue of their sheer reach are better placed to recover these loans (Viswanathan, 2002).

Lok Adalats and Debt Recovery Tribunals are other effective mechanism to handle this task. ARCs should focus on the larger borrowers. Further, there is a need for private sector and foreign participation in the ARC. Private parties will look to active resolution of the problem like NBFCs and not merely regard it as a book transaction. Moving NPAs to an ARC cannot solve the problem. In China, potential investors are still worried about the risks of non enforcement of
ownership rights of the assets they purchase from the ARCs. Actions and measures have to be taken to build investor confidence.

ARCs services are not available to NBFCs. Rather NBFCs are better at managing receivables due to the expertise available to them.

2.3.3 Securitisation
This has been used extensively in China, Japan and Korea and has attracted international participants due to lower liquidity risks. The Resolution Trust Corporation has helped develop the securitization market in Asia and has taken over around $ 460 billion as bad assets from over 750 failed banks. Its highly standardized product appeals to a broad investor base. Securitization in India is still in a nascent stage but has potential in areas like mortgage backed securitization. Securitization route can help NBFCs also to increase liquidity and to reduce the "Bad debt" problems. But if resorted to, can weaken the internal strength of recovery. Probably it is more suitable for those financiers who are totally depending on "out servicing for recovering this out standing"

To test a long known fact that it's the unwillingness to pay, not the inability that is responsible for poor recovery/non recovery of loans. There is huge narration, description but no systematic incretization of this incidence. Empirically, it is seen that the probability of willingness to repay the loans varies inversely with the level of income and the size of land in the rural India (Meta V. 2005).

2.3.4 Online Debt Collection
Past due accounts receivables pose a constant problem in many business. Sometimes the time and effort to get paid will exceed that needed to make the business function efficiently. This makes an efficient system of contacting the
past due accounts. There are basically four stages of debt recovery that are employed by business.

The various incidents involving recovery agents also attracted the attention of the regulators. In February 2007, the Supreme Court of India expressed concern that the banks were not adhering to the rules framed by the Reserve Bank of India (RBI) and the Indian Banks Association (IBA). RBI's guidelines stated that recovery agents could not resort to "harassment of any kind, either verbal or physical, against any person in their debt collection efforts, including acts intended to humiliate publicly or intrude the privacy of the credit card holders' family members, referees and friends, making threatening and anonymous calls or making false and misleading representations."

2.4 Defaults

It is now not just the customers, but even the dealers of two wheelers will come under scrutiny of loan defaults, as many banks pull out of financing the segment in many parts of the country. According to two wheeler companies and banks, one of the reasons for high defaults has been dealers' negligence to ensure registration of vehicles. Manufacturers would be required to put pressure on the dealers to ensure registration of vehicles. Unlike in the metros and other smaller cities where dealers are required to register the vehicles, in many of the interior regions dealers sell the vehicles which later don't get registered. This makes it difficult for the banks to retrieve the vehicle even if there are defaults (Vyas, 2008).

IONIA- Independent Bank Corporation saw provisions for loan losses eat into its earnings for the first quarter, continuing a trend that has troubled other banks in
the region. The Ionia based company reported profits of 3,00,000 US dollar for
the quarter, one cent per share, compared with profits of 4.2 million US dollar or
18 cents per share, in last year's first quarter. The bank's 3.2 million US dollar
increase in its provision for loan losses was the biggest factor dragging down the
results during the three months from January to March 2007. Its total provision
was 11.3 million US dollar at the end of the quarter compared to 8.1 million US
dollar at the end of the first quarter of 2007 (Knape, 2008).

Regarding the bulk of the troubled loan tied to residential developments the bank
said, "Our elevated level of non performing loans is closely aligned with a
general slowing in the residential housing market, and the effect of this slowing
has had on borrowers, including several residential real estate developers, who
came past due on their loans in recent quarters." "The rise in non performing
commercial loans during the first three months of 2008 was disappointing.
However, nearly all of these loans were already in watch credit and therefore
had been identified as a potential problem" (Knape, 2008).

The above article highlights the need for better management of the receivables
failing which non performing assets will rise and the loan losses will eat into the
profits of financier.

The Mortgage Bankers Association has reportedly estimated aggregate housing
loan default at around 5 percent of the total in the last quarter of 2006, and
defaults on high-risk sub-prime loans are as high as 14.5 percent. With a rise in
so-called 'delinquency rates', foreclosed homes are now coming onto the market
for sale, threatening a situation of excess supply that could turn decelerating
house price inflation into a deflation or decline in prices. The prospect of such a
turn is strong given the estimates by firms such as Lehman Brothers that mortgage defaults could total anywhere between $225 billion and $300 billion during 2007 and 2008 (Chandrasekhar and Ghosh, 2007).

Debt collection is one of the top five fastest growing industries and that speaks of the importance of receivable management both in finance companies and non finance companies.

2.4.1 Bonanza for Defaulters

There have been reports that the banking industry is planning to bring out a package by which defaulters can repay the loans they had taken through a one time settlement. The reports say the repayment amount could be as low as 50 percent of the principal. This plan, if implemented, can be disastrous. There are cases of the borrowers deliberately bringing their businesses to sickness so that concessions attached to nursing arrangements can be demanded, while regular borrowings are costlier (Subramanyan, 2002).

2.4.2 No Recovery, No Fee Service

There are various commercial collection agencies internationally and they substantially advertise with various captions like 'No recovery, No fee service' etc. There are various recovery agencies available internationally. Dependence on such agencies may only weaken the internal recovery strength of any organization. NBFCs for their managing receivables need to be stronger with tailor-made solution in managing these receivables.

2.5 Credit Policy

The single most important contribution that a credit department can make to the success of a company is to have a credit policy that is tailored to the needs of
the company, and to so effectively implement that policy as to ensure the achievements of its stated goals. Unless the credit manager grows at a rate faster than his Company, the Company will not benefit from the level of management skills essential for the protection of receivable balances (Bond, 1993).

In any credit department there may be occasional mistakes or errors in judgement. This will occur regardless of how diligently the manager or the supervisor monitors the work of associates, but good management skill will minimize the magnitude and frequency of those mistakes. When a mistake does occur, it can be identified as a growth step rather than an act of carelessness or incompetence. Every mistake has a price tag, but the tag on one that can be identified as a growth step and can be prorated over and absorbed into an impressive number of positives (Vanhome, 1996).

The size of a company or business is irrelevant to the indisputable fact that a written credit policy is a necessity for any business especially that for a finance company. Whether credit decision will be made by an experienced professional, by less experienced professional or by an entrepreneur, has obvious relevance as it relates to expectations for the quality of results (Khan, 2004).

2.5.1 Marketing Men’s View of Credit

Most critics of the credit policy of an organization are normally their own marketing team. It is always good to have healthy criticism from once own marketing men. It is very good in a sense that it will always help the credit policy framers to have self corrective mechanism on the credit policies. But it is highly necessary that marketing men are convinced about their own credit policy at
least in their consciousness even though they criticize among the credit team. It is always necessary to understand the credit policies of industry peers and make changes on credit policy from time to time. One need not copy or follow the credit policy of a competitor or a successful company and can have their own version or changes as required, suiting or acceptable to the stake holders. Careless formation of a credit policy may not be good enough to penetrate and sustain in the market. As mentioned earlier credit policies should invariably have a bearing on the quality of the product, services provided and its price or interest.

Higher the interest, poorer the quality of service, and rigid a credit policy may not suite any financial organization to achieve their target of business and sustain in the financial market.

The primary incentive for putting up the credit department on a solid foundation is the 'profitability' of the organization. When the credit department puts varying amounts of the company assets at risk, the degree of risk depends largely on the knowledge and experience, especially the professional knowledge and experience of the credit manager and his knowledge of the accounts and experience with conditions of the industry (Bond, 1993). When an account or customer is new, the degree of risk hinges not only on the customers' references, but also on the level of experience the credit manager and team bring to the evaluation process. The credit manager must be qualified and experienced to evaluate the information and data received from the borrowers and their bank references (past track record) if any available, and weigh the quality of available financial statements and other credit information. The field investigation reports are also gathered. The manager must also be qualified or capable enough to evaluate the reports from reporting agencies such as Dun
and Bradstreet, the national association of credit management as far as global scenario is concerned. Of course even in India there are agencies like CIBIL available with sufficient legislative support, who supplies the track record of borrowers, of various financial products.

2.5.2 Credit Policy Variation

There is a wide range of variation in the credit policies of various nationalized banks itself and that speaks for adaptation of proper credit policy, especially when we have banking companies with different organizational culture (even though the regulator RBI and the regulation for all banks are common). Let us merely look at the organizational culture of foreign banks, state banks, other nationalized banks, new generation private sector banks, Old private sector banks, Regional Rural Bank, etc. All of them are operating in the same financial markets of the country. However, each has varying credit policies and investment pattern and assets are also chosen which suits them. Many remain with in their typical specialization area and niche market.

2.5.3 Credit Policies

It is pertinent to mention that even among NBFCs it is difficult to adopt common credit policies or norms. Each has to choose its assets specialization, and niche market and serve in its own typical style for its survival. Unlike in trading and manufacturing, branding labelling and product differentiation is quite difficult as the end purpose is 'Rupee'. However, financier and banks are from time immemorial trying to differentiate their product and continue to capture the market in their own way. All these speak for the importance for framing a credit policy which suits their own conditions, rather than merely banking up on the policies of competitors. Of course one cannot deviate much from the industry practices.
2.5.4 Types of Credit Policies

Three basic types are (1) Restrictive Credit Policy (2) Moderate Credit Policy (3) Liberal Credit Policy (Bond, 1993).

Restrictive Credit Policy

This is a credit policy of a company that has no plan to grow at a rate that is more than minimal. The company is unwilling to undertake risks that are more than minor to do business with customers whose paying habits almost never vary.

Moderate Credit Policy

The moderate credit policy mixes good accounts with average accounts. It is a more conventional mix of credit risks than the conservative or liberal approaches to credit.

Liberal Credit Policy

This is the most dangerous of the three credit policies. A liberal credit policy is a high risk policy. Risks are higher, the loss of receivables can be heavy and there can be real danger to financier’s survival.

2.5.5 Credit Procedure

Credit policy is to be differentiated from credit procedure. Credit procedure is the tool and the process required in evaluating the borrower. Good credit procedure eliminates many of the elements that can lead to costly mistake.

The size of a company or a business is irrevalent to the indisputable fact that a written policy is necessary for any business and especially that in the financing business (William et al., 1978).
Credit decisions must be consistent with the guidelines incorporated into the company's credit policy. If changes in business or economic conditions make it obvious that the credit policy is very restrictive, the written credit policy should be changed to reflect the changes in the acceptable parameters. Some flexibility must be infused into every credit policy or plan.

The three basic credit policies as we have seen are restrictive, moderate and liberal. Each type of policies involves a different mix of ingredients, a somewhat different business philosophy, different goals and different financial needs or a combination of the three policies; i.e., some thing from one, a few things from another, and one or two guidelines from the third. A credit policy tailored for a company from one or more of the basic categories of policies are acceptable (Brain, 1995).

2.5.6 Assessment of Credit Risk

Proper assessment of credit risk is important as it helps in establishing credit limits. In assessing credit risks, two type of error occurs.

Type 1 error i.e., a good customer is misclassified as a poor credit risk.

Type II error i.e., a bad customer is misclassified as a good credit risk.

Both the errors are, as it results that Type I error bounds to loss of profit or sale of good to customers who are denied credit. Type II error results in bad debt losses on credit sales made to risky customers.

2.5.7 Collection Effort

Collection programme or collection procedure of an NBFC is mainly aimed at timely collection of receivable. However, it should be remembered that collection effort is also a major variable in the credit policy of a finance company. A strict
collection procedure tends to decrease the advances. But it is a universal phenomenon that if the collection period is reduced bad debt will also decrease. However, it will increase the collection expenses and this will lead to a decrease in advance. A relaxed collection programme on the other hand will increase sale, will also increase the receivable outstanding and bad debt percentage. So there need to be a trade off between strict and relaxed collection polices.

2.5.8 The Formulation of Credit Policy Models

This study undertakes to apply the statistical technique of sequential decision process to a specific range of problems of (trade) credit management. In particular, the study examines two problems: first, credit extension policy on a specific request or account; and second, construction of indices measuring the effectiveness of such a policy. The end goal is to establish a control system which has heretofore resisted analytical solution. Since management exercises its discretion primarily during the credit-extension phase, and since subsequent phases of credit policy are closely related to this particular phase, attention is focused on this aspect of credit policy. However, the analysis does not ignore other important aspects of credit policy, such as bad-debt level, length of the credit period, collection activities, and level of lost sales. The above situation is then reversed: indices in terms of bad-debt level, receivable level, etc., measure the impact of credit extension procedures on the subsequent phases of credit policy. The strength of the suggested approach lies in the logical relationship between the operating decision rules, that meaningfully take into account past experience, and the control indices. Thus it helps management in framing the optimal credit policy. The limitations of the study, such as the implied assumption of linearity of cost data and the neglect of cash discount policy or an integrated
investment scheme, do not detract from the operational usefulness of the suggested approach (Mehta, 1968).

2.5.9 Credit Culture

One may need to go for loans to gather adequate funds to buy a vehicle of his choice. But sometimes his financial circumstances deceive and fail to pay the loan amount back in time. The lender keeps on causing nightmares and credit score also gets damaged. In such cases refinancing is the ultimate option and refinance auto loans with bad credit are the perfect tolls in this respect (Muallakinakala, 2008).

One may not run at a constant speed on the economic turf. Sometimes financial situation turns in such a shape that suddenly fall into a trap of emergencies. One need quick funds to settle those emergencies but you fail to arrange adequate amount of money. In such situations one need not wonder in the market with the loan applications. Rather you just need to relax and go for the auto title loan (Marwarne, 2008).

2.5.10 Credit Evaluation Models

The CAMEL Model

Most analysis and credit rating agencies go by the CAMEL model when it comes to evaluating NBFCs. The acronym: C stands for capital adequacy, A stands for asset quality and asset profile in the context of evaluating NPAs, M for management quality of the NBFCs, E stand for earnings (spreads) and L for liquidity. As for how good the spreads are, can be assessed using the ratio of operating costs to total assets ratio. Higher the operating cost, lower the spread.
CAMEL apart, asset-liability management (ALM) is also a vital indicator of an NBFC's fundamental strength. ALM analysis can throw up mismatches in an NBFC's balance sheet.

Not everyone is using the CAMEL model. For instance, RBI is using conventional ratios to track NBFCs and the regulator does not have any specific format for evaluating NBFCs. It is left to the discretion of the RBI inspectors to use a particular ratio while examining an NBFC.

Thanks to the fact that margins of NBFCs are under constant pressure and it is important to understand how NBFCs source their funds. The very survival of NBFCs depends on effective sourcing of funds. The yardstick with they are measured shows the extent to which NBFC has been able to leverage its assets, to obtain bank finance and their exposure to the banking system.

Assessing NPAs is necessary to gauge the strength of an NBFC. So, it is prudent to use the accounts receivable to business volume ratio to know how good the receivables are, how good are the NBFC's recovery systems and whether the NBFC has excellent account receivable management in place.

The net NPA ratio which expresses NPA net of provisions to total advances net of provisions too is important in understanding the soundness of accounts receivable management of the company. This ratio can tell an NBFC's top management whether debt restructuring is needed.

Almost without exception, all business entities carry some type of receivables and loans on the face of the balance sheet. Ordinary operations give rise to
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finance lease receivables; trade receivables; receivables due from customers under construction contracts; financial instruments with positive fair values and short term loans.

Credit allows customer to obtain goods or services in return for a promise to pay in the future. Today credit shopping is a way of life for many people. One will need to make several decisions on how they will advance credit to their customers. It is important to properly evaluate before granting credit.

CREDIT Information Bureau (India) Ltd. (CIBIL) now has a database of 8 million records of the credit history of individual consumers taken from various banks, financial institutions and non banking finance companies. The database is expected to touch 10 million records by November 2004.

Financial institutions, housing finance companies, and banks, which subscribe to the service, can query CIBIL about the credit history of these borrowers on the payment of nominal fee (Vageesh, 2004). Proper utilization of such data base can find some answers for the credit evaluation in NBFCs.

2.5.11 Intermediaries and Monetary Theory

The Gurley-Shaw interpretation of the effects of financial intermediaries and their implications for monetary theory and policy rests upon certain basic theoretical innovations of the authors. It seems desirable to have some explicit discussion of the ideas in question. Unless they are correct, the major Gurley-Shaw argument and its important and widely discussed policy conclusions would seem to be untenable. On the other hand, if these ideas are valid, they call for wholesale revision of thinking about monetary theory and economic stabilization.

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The Gurley-Shaw innovations discussed below are not valid and, therefore, that the authors' argument cannot be accepted. It is impossible here to summarize or to comment on all matters dealt with in the articles in question. This paper limits itself to discussion of certain theoretical innovations that seem to the present writer to be of fundamental importance and to play an essential role in the Gurley-Shaw argument. The main issues can be summarized in two questions: (1) Do commercial banks differ from financial intermediaries in their ability to create credit in any sense that is significant from the point of view of financial control over the economy? (2) Are the concepts of "direct debt" and "indirect debt" useful tools for analyzing financial developments and an appropriate basis for formulating government financial policies to combat instability? Are commercial banks unique in their ability to create credit? Gurley and Shaw explicitly propose a departure from the usual way of looking at the role of banks in the economy. There is deviation from conventional doctrine regarding the banking system as one among many financial intermediaries, sharing with the others the functions of indirect finance. Take exception to the view that banks stand apart in their ability to create loanable funds out of hand, while other intermediaries in contrast are busy with the modest brokerage function of transmitting loanable funds that are somehow generated elsewhere. This difference of view, whatever one may decide is its exact nature, would seem to have policy implications.

The present day bankers have the dilemma to lend or not because of their receivable management problem (Chowdhary, 2005).

With recent RBI regulations paving the way for the sale of bad loans, banks seem set to offload their heavy burden of NPAs, and make some hot cash in the process.
The much-maligned non performing assets (NPAs) of Indian banks are poised for a major makeover with the RBI paving the way for the sale of bad loans between banking and non banking financial institutions (Krishnan, 2005).

### 2.6 NBFCs

So long as the performance of NBFCs is within the guidelines laid down by the RBI and their capital adequacy and lending operations are in order, no purpose is served by a ceiling on lending by banks to NBFCs. Indeed, this would amount to subverting priority lending (Venkitaramanan, 2006).

Finance theorists have argued that banks have a comparative advantage over public debt holders and other suppliers of debt both in gathering information about and in monitoring corporate borrowers. Although underwriters of public debt issues and private placements have access to inside information when executing specific transactions, commercial bankers have ongoing relationships with their corporate borrowers that have often been built up over years. Perhaps more important, banks are also often in a better position and have stronger incentives than a dispersed collection of bondholders to keep tabs on what the borrower do after receiving the capital (Datta, Datta, Patel, 2007).

Bank relationship matters in public debt offerings. This is applicable in case of NBFCs also. As the authors interpret their findings, a banking relationship not only helps to ‘certify’ the value of corporate borrowers to their stockholders, but also provides other lenders with valuable ‘cross-monitoring’ benefits that are reflected in lower borrowing costs.

#### 2.6.1 NBFCs- Creditable but Unrecognized Role

In a large country like India with substantial service sector activity, it is important that the role played by NBFCs in credit provision is recognized. They have an
extensive network and credibility among their constituents, both borrowers and lenders. In fact, for the unorganized sector they are the source of finance. But they are being given the short-shrift (Vaidyanathan, 2005). Bank financing of trade (non food credit plus food credit) totaled Rs. 72,057 crore in 2003 or about 40 percent of the credit absorbed by the sector (RBI Annual Report 2004). In other words, more than 60 percent of the financial requirement of the non corporate sector in trade is met by NBFCs. This again is an under estimation as a substantial amount of the food credit by banks goes to government organizations such as the Food Corporation of India.

Remember that the truck financing activity is the most innovative and efficient symbol of the NBFC sector. Second-hand truck financing has created a fascinating backbone for the transport industry by focusing on the small man and this has been one of the major contributions of the NBFC sector to the economy. One can, therefore, say that the role of NBFCs in the credit delivery system in both manufacturing and service is significant per se compared to the commercial banks also (Vaidyanathan, 2005).

2.6.2 Are NBFCs being Hounded Out?

A microfinance institution or even a non governmental organization can borrow money through the ECB (external commercial borrowing) route, but not NBFCs, which have been doing just micro credit for the last half century (Ramesh, 2005).

The RBI guidelines restricting deposit-taking by NBFCs are 'irrational' and said that the "RBI should appreciate what would have happened if one of the public sector banks, with a weak bottom line and high NPAs, had been prohibited from receiving fresh deposits, which is what was done to the NBFCs..." (Venkitaramanan, 2008).
2.6.3 Financial Body gets Board

The Ministry of finance and Development planning has appointed a six-member board of directors for the newly formed Non Bank Financial Institutions Regulatory Authority.

The regulatory authority was formed after Parliament passed the Non Bank Financial Institutions Regulatory Bill in December 2006 to regulate non bank financial institutions including micro lenders.

Since the non bank financial sector is a fast evolving environment, it demands a regulatory body that is flexible, independent and robust to respond to supervisory and financial sector stability challenges. Even though the Non Bank Financial Institution Regulatory Act will be regulating the non bank financial institutions, it is said that the Ministry of Finance and Development planning may also issue policy directives to the regulatory authority (Tumelo, 2008).

The classification of NBFCs has been changed over a period of time. The functioning of different categories of NBFCs are not governed by the homogeneous factors. Therefore financial implication can differ for different group of companies. The financial performance of 10 leasing companies has been examined by Saggar (1995) at disaggregate level and compared with other groups of NBFCs for a period of 1985-90. Moreover, a study by Harihar (1998) throws light on the performance of all NBFCs taken together in terms of cost of debut, operating margin, net profit margin, return on net worth, asset turn over ratio etc. The study by Saggar does not reflect the overall performance of NBFCs as it is based on selected 10 companies. The study by Harihar reveals the aggregate performance of NBFCs which does not throw light on the financial
performance of different groups of NBFCs. In the light of these limitations, the study of Kantawala (2001) attempts to examine the financial performance of different groups of NBFCs separately. The study attempted to examine the relative financial performance of different groups of NBFCs for the period 1985-86 to 1994-95 in terms of profitability, leverage and liquidity. The reasons of selecting this period for the purpose of study were (a) During this period the number of NBFCs has flourished by leaps and bounds. (b) The absolute amount of deposits with NBFCs have gone up from 4956.6 crore to Rs. 85495.1 crore (increase is almost 17 times). (c) The share of deposits with reporting NBFCs have gone up over a period of time from 4.78 percent to 16.49 percent (The share is as a percentage of total deposits of Reporting NBFCs Non financial Companies and scheduled commercial banks) (RBI Bulletin, 1997). It also attempts to find out the groups for which majority of the ratios are same (Kantawala, 2001).

On the basis of the study, it was concluded that there exists a significant difference in the profitability ratios, leverage ratios and liquidity ratios of various categories of NBFCs. When two categories were examined against each other, then the more number of ratios were not statistically different from each other in majority of the cases except where TS+IH are compared with leasing. When all categories are taken together, null hypothesis is accepted for only three ratios indicating thereby that there does not exist a significant difference in only three ratios. From this it follows that the ratios for all categories of NBFCs are generally different from each other. The analysis of variance along with the details about average ratios may become a useful guide to companies to decide about diversification or continuation in the same line of business considering over all profitability within the regulatory framework. In short, different categories of NBFCs behave differently (Kantawala, 2001).
2.7 Regulation of the Activities of NBFCs in Selected Countries

Diversification of the financial sector has been one of the central features of economic growth in several countries. Central feature of the evolution of the financial system has been the emergence of non-banking financial institutions outside the traditional banking system, including finance companies, leasing companies, merchant banks and trust investment companies. While the willingness of these companies to engage in varied forms of financial intermediation hitherto unavailable to the banking system, has provided the countries with valuable flexibility in financing. Their complex range of activities has opened up challenges for policymakers and regulators to integrate the functioning within the overall framework of the financial system. The regulatory framework for NBFCs in different economies is discussed below (Reserve Bank of India; Asian Development Bank, 1994; Faruqi, 1993; Luckett, Schulze and Wong, 1994).

The system of regulation of NBFCs in a few countries has been studied with a view to drawing lessons from their experiences. The countries include the United Kingdom (U.K.), the United States of America (U.S.A.), Australia, Malaysia, West Germany, Hong Kong and Singapore. The U.K. has a well diversified financial system. NBFCs are regulated by a separate legislation and the SRO concept has been well received in the U.K. as in U.S.A., NBFCs provide varied range of services and their deposits are also insured as in the U.K. In Australia, the NBFCs are regulated by an act which operates concurrently with State and Territory laws. Many NBFCs have converted themselves into banks in recent years. In West Germany, a different set of regulation is laid down for each category of NBFCs. In Malaysia, a wide variety of institutions are operating in an environment of macro-economic stability. In Hong Kong, a single set of regulations governs both banks as well as deposit taking institutions. In Singapore, finance
companies operate along the same line as commercial banks except that they cannot operate current accounts. Thus regulatory framework for governing NBFIs in each of the countries has certain special features and has relevance one way or the other to the Indian situation; a study of the same would enable one to understand their characteristics and draw lessons for NBFIs in India.

**Australia:** The registered NBFCs in Australia were regulated by the Reserve Bank of Australia till June 1992 (under the Financial Services Act, 1974). However, since 1992, the work of regulating and supervising building society and credit unions, which constitute the major segment of the non banking financial institution, had been delegated to the Australian Financial Institutions Commission (AFIC), with the RBA retaining the power to focus exclusively on supervision. In 1992, these building societies and credit unions were brought under the jurisdiction of a principal statutory law.

**France:** The French banking system consists of a large number of credit institutions which may be authorized as banks, mutual or co-operative banks, savings and prudential institutions, municipal credit banks, specialized finance institutions and financial companies- all of whom are governed by the French Banking Act of 1984. Under the Act, credit institutions need an authorization from the French banking system before beginning their operations.

**Hong Kong:** Hong Kong maintains a three-tier system of deposit-accepting institutions, viz., licensed banks, rest licensed banks (RLBs) and deposit-taking companies (DTCs). They are collectively known as authorized institutions (Als) and are subject to the supervision of the Hong Kong Monetary Authority (HKMA). The Banking Ordinance of 1986 constitutes the legal basis for the HKMAs powers to regulate and supervise Als. Licensed banks alone are permitted to conduct the full range of retail and wholesale banking business.
Indonesia: Insurance companies comprise the largest non bank intermediary in Indonesia. The relatively important insurance companies grew substantially in the decade of the eighties. However, almost half of the assets of the insurance industry are held by five government-owned social insurance companies which primarily provide pension health insurance and workers' compensation for the employees of government agencies. As part of the deregulated measures announced in the late 1980s, insurance premiums have been de-regulated and since 1988, these have been left to market forces. Prudential regulatory requirements for life insurance, casualty insurance and re-insurance and restrictions on their investment portfolios were established in the 1990s.

Malaysia: The banking system in Malaysia comprises of three different types of institutions, viz, commercial banks, finance companies and merchant banks. They are licensed and governed under the Banking and Financial Institution Act, 1989 (BAFIA). Only a public company holding a valid license granted by the Minister of Finance on the recommendations of Bank Negara Malaysia (BNM) is allowed to carry on banking, finance company or merchant banking business.

Pakistan: For the last many years, the non bank financial sector has carved out a place for itself in Pakistan's financial market, even though a large portion of financial assets continue to be managed by commercial banks. Prior to December 2002, leasing companies, investment banks, house finance companies, brokerage houses and others largely operated in their respective niches, while the State Bank of Pakistan and the Securities and Exchange Commission of Pakistan (SECP) shared regulatory responsibilities within the non bank financial sector.
Singapore: Finance companies in Singapore are governed by the Finance Companies Act, which are administered by the Monetary Authority of Singapore (MAS). In accordance with the Act, only those finance companies which have been granted licenses are permitted to transact financing business. Except as provided in the Act, a finance company is not permitted to carry on any kind of business other than financing activities. They are also not permitted to account any deposit which is repayable on demand, by cheque, draft or order drawn by a depositor on the finance company. The Finance Companies Act was revised in 1994. The amended Act, *inter alia*, stipulated minimum capital requirements of US$ 50 million, capital ratio not less than 12 percent, maintenance of a reserve fund and transfer prescribed amount to that fund out of the net profits of each year.

Thailand: Non bank savings institutions consist of various units, which include, among others, finance companies credit foncier companies and life insurance companies. The finance companies in Thailand are regulated under the Act on the Undertaking of Finance Business, Securities Business and Credit Foncier Business, 1979, which was subsequently amended in 1985. Newly developed prudential control measures relating to capital adequacy ratio, liquidity ratio, single lending limits, portfolio investment limits, and disclosure requirements are covered under the Act and are designed to follow international best practices.

United Kingdom: The two major enactments which regulate deposit taking and investment business in the UK are the Financial Services Act, 1986 and the Banking Act, 1987. The prime objective of the Banking Act is the protection of depositors' interests. The Financial Services Act, on the other hand, regulates the investment business. Over and above these, there are statutes which
regulate the activities of specific categories of companies, such as the Building Societies Act, the Friendly Societies Act, the Insurance Companies Act, the Loan Societies Act and the Credit Unions Act.

**United States of America:** All financial institutions which do not accept demand deposits and/or do not offer commercial loans are classified as NBFIs. NBFIs include insurance companies, investment banks and brokerage firms, real estate companies, finance companies, mutual funds, pension funds, savings and loan associations, mutual saving banks and credit unions. All these institutions are classified into five categories, viz., Deposit-type NBFIs, Contractual-type NBFIs, Investment-type NBFIs, Financial Companies and others. In recent years, the distinction between different classes of financial institutions has become increasingly blurred in the USA. The non-banking financial intermediaries are governed by the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA).

**Germany:** Non-bank financial institutions are governed by special/supplementary laws in Germany. The enactment regulating these institutions are the Mortgage Bank Law and Investment Companies Law, Stock Exchange Law, Securities Deposit Law, the Cheque Law and the Bill of Exchange Law. These regulations apply to all institutions including building societies, postal giro offices and postal savings banks which are not subjected to the KWG (Banking Act applicable to commercial banks).

The aforesaid discussion suggests that the regulation of NBFCs in different economies has evolved over a period of time, depending on the country’s political-economy and socio-economic considerations. As the consolidation of
the NBFC segment in India gathers momentum, there is the need for the regulatory framework to be tailored to meet the needs evolved in situation as evidenced in these countries.

2.8 Global Experiences

After a hike in the price of fuel was announced in Malaysia, banks have come up with a variety of creative auto loan solutions which will help consumers survive the price rises. This speaks of the necessity of rescheduling in vehicle financing in India especially by NBFCs who are better known for tailor-made solution for borrowers.

2.8.1 Financial Intermediaries

Financial intermediaries play a vital role in building economies. It is found that the sources and the uses of funds are not one and the same in different economies world wide. This process is also so complexly structured that while individual contributions comprise the major source of funds to the market, the utilization of funds is done by different sectors in the economy. Capital formation comprising of saving and Investment holds the key to this process (ICFAI University, 2007).

2.8.2 Embedding Trust and Transparency in American Business

In the growing and dynamic economy of 19th century America, businesses sold vast quantities of goods to one another, mostly on credit. It explains how business men resolved the problems of whom to trust regarding credit and to what extent. In the process, a business system based largely on information circulating through personal networks became dependent on more formalized methods and institutions, First to appear in the 1830s was the credit reporting
agency, whose pioneers included the abolitionist Lewis Tappan, and businessmen John Bradstreet and Robert G. Dun (whose firm merged in 1933 to form Dun and Bradstreet). Later, groups of business creditors formed interchanges and bureaus to share information on their customers' payment records. In 1896, the National Association of Credit Men (later to become the National Association of Credit Management) was established, any by 1920, credit men had established both a national credit information clearinghouse and a bureau for American exporters (Olegario, 2006).

An article in the Daily Sentinel reveals terrorist threat that occurred on 2300 block of Cotton Street an employee of a loan company attempted to collect on a loan at someone's home and was threatened with a knife. The employee did not wish to file charges. The problems that financiers encounter in collecting their dues are quite clear from the above article.

A woman was found with multiple stab wounds on her back near the police college in Cheras, the suspect has been apprehended- all because he defaulted on his vehicle loan payments. The taxi driver from Kuala Kangsar was handed over to the police after car repossession saw bloodstains in his taxi (Shi-lan, 2008). Similar incidents are quite common on the vehicle repossession in India too.

2.8.3 Customer Loan Default in Turkey Double Last Year

The economic slow down in Turkey has negatively affected interest rates on vehicle and home loans, doubling the number of people who have defaulted on loans in 2007 compared to the previous year, according to a statement from Deputy Prime Minister Nazım Ekren (Ankara, 2008).
Lenders have a duty to help borrowers who get into difficulties. "The Financial Services Authority has a rule that says all customers must be treated fairly and borrowers in difficulty must be dealt with sympathetically" (Robson, 2008). The article speaks about the importance of customer care and customer education. In India, RBI has already initiated steps.

Though, that even if assets are repossessed it does not necessarily mean that problems are over, the costs of any arrears and the repossesson are still once responsibility. If the property is sold for less than the total debt the lender will still look at to repay what's outstanding. Unfortunately, giving up the property may not be the end of troubles.

2.8.4 Biggest rise in Home Repossession Threats since 1991
The number of people threatened with repossession after failing to keep up mortgage payments has risen by 16 percent over the past year in another sign of the crisis in the property market (Hopkins, 2008). This is true in India also.

The general rule of thumb is that the shortest loan term, the more likely the borrower and the bank will be able to successfully complete the terms of the loan. Part of the reason for tightening credit going forward is for trying to ensure that those future loans will stay on the books as positive loans (McClatchy, 2008).

In India, there are similar situations. 60 month tenure and for a vehicle loan is too longer period especially vehicle changes are fast taking pace may be percentage of funding has to come down.
Securitization of receivables usually involves the sale of cash flows generated by a company's existing pool of assets, "future flow" transactions are backed by
income to be derived in the future by an operating company. The route of securitization is adopted even in India by some NBFCs.

Accounts receivables are the part of the working capital. It provides the detailed information on accounts receivables as receivables reflect money, goods, or services which have been earned but not received.

2.8.5 Monitoring by Financial Intermediaries: Banks vs. Non banks

Recent empirical evidence indicates that capital markers respond positively to debt-financing announcements in the form of loan agreements. Non bank firms, prompted largely by technological and telecommunications advances, have also entered the commercial lending market in recent years. It is found evidence that borrowing firms experience positive abnormal returns upon announcing conclusions of loan agreements with non bank firms. Evidence suggests that non banks have replicated some of the unique attributes formerly enjoyed only by banks (Preece, Mullineaux, 1994).

So many people are in way to deep when it comes to debt but they are unaware of it. It is constantly surprised at the way people tell that they have everything under their control. Yet, they don’t have enough money to pay the bills without juggling things around. Or they can’t buy groceries. Or they may start saving for retirement tomorrow, not realizing that tomorrows add up to too late (Lukac, 2007).

2.8.6 Lessons from the US Sub-prime Lending Crisis

All eyes are directed at the housing market afflicted with a meltdown in its sub-prime mortgage segment. With housing asset values having driven the US economy which, in turn, serves as locomotive for the rest of the world, fears are that this American disease could trigger a global epidemic of slowdown. The
assumption is that the original problem is quintessentially American. If it is not, argue Chandrasekhar and Ghosh, the US experience can have lessons for countries such as India (Chandrasekhar, Ghosh, 2007). There is a lot to learn from the lessons of sub prime crisis of US, as the vehicle finance is heading heavily towards sub prime borrowers especially due to the competition. If the recovery guidelines of RBI for Banks and NBFCs are implemented in its letter and spirit there could be a crisis for vehicle financiers especially for NBFCs in short term.

Since 1994, the Kaulkin report has been the authoritative report for the collection industry and many have referred to it as the 'industry bible' (Legrady, 2005).

It is commonly agreed that accounts receivable (AR) can be a source of financial difficulty for firms when they are not efficiently managed and are underperforming. Experience across multiple industries shows that effective management of AR and overall financial performance of firms are positively correlated. The problem of reducing outstanding receivables through improvements in the collections strategy, was discussed especially to demonstrate how supervised learning can be used to build models for predicting the payment outcomes of newly-created invoices, thus enabling customized collection actions tailored for each invoice or customer (Zeng, et al., 2007).

Accounts receivable is the net monetary value realized by an organization through sales. The parameters affecting accounts receivable management include level of sales, terms of sales, and quality of customer. This is important in case of NBFC financing also.
Australia has become a refuge for a new endangered species: the high-flying banker. Bankers facing lay-offs in Europe and the US are looking increasingly at Australia’s drum-tight market (Leforte, 2008).

2.8.7 Competitive Environment of Western Banking

Across Western countries there are striking variations in the configurations of financial systems. In some countries, such as the U.S. and U.K., financial markets have been very important for the allocation of resources. In others, such as most Continental European countries, banks have played a more prominent role and financial markets are less developed. In many countries, banks do not hold major equity stakes in industrial companies, while in others, notably Germany, banks are among the largest shareholders. These differences have a long history and could be purely coincidental, but more likely depend on each country’s evolution of industrial structure. The varying extent of government involvement could also explain some of these differences. This is particularly true in the U.S. where rigid regulatory structures have fragmented its banking system.

Stability and competitiveness are very likely to be conflicting rather than complementary objectives, thus presenting regulators with a difficult trade-off. In the popular view, restrictions on competition would improve banks’ profitability, reduce failure rates and hence safeguard stability (Demsetz, Saidenberg and Strahan, 1996).

The traditional regulatory approach to Western banking implicitly guaranteed stability by reducing competitiveness. The competitive reality of today makes this approach no longer viable. Banking is in flux. It is thus important that one
(re)examines the issues of competitiveness and stability. Given the distortions associated with intrusive direct and indirect forms of regulation, it is important to design a banking structure and regulatory framework that make the operations of financial institutions minimally dependent on regulation and supervision.

2.9 Vehicle Finance

Getting an automobile loan is quite easy now-a-days. Organized and institutional auto finance has come of age and companies are aggressively marketing auto loans schemes by offering innovative and tempting offers to the customers. Most of the lending institutions finance up to 90 percent of the cost of the car, depending on the model of the car and the repayment period. Margin Money scheme, Advance equated monthly instalment scheme, Security deposit scheme, Hire Purchase scheme.

Increasing number of borrowers with bad credit records are resorting to taking out loans with exorbitantly high interest against the value of their cars, according to debt counseling charities (Qureshi, 2008).

The practice, known as 'logbook lending', involves specialist companies lending up to 50 percent (sometimes more) of the trade value of the car in return for crippling levels of interest, often in excess of 340 percent.

The borrower signs a credit agreement and a ‘bill of sale’ which temporarily transfers ownership of the vehicle to the lender- and gives them the right to take possession of it should the borrower fall behind with payments. The company also retains all original documents pertaining to the vehicle, including the insurance certificate, MOT certificate and the V5 registration document, which holds details about the car’s owner (Qureshi, 2008).
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Having a new car is one of the biggest achievements that most people can have. Purchasing a new car involves high expenditure as in financing education or buying a home.

Car financing companies vary on the interest rates they offer to customers. A customer with a good credit history does not have to pay a high interest rate compared to a person with bad credit history. And if one really want to secure car financing with low interest rates, one should try looking for an online car financing company. By applying for loan online, one save the company time and money, thus the savings from the cost of doing business are passed on to customers (Stith, 2007).

2.9.1 Two wheeler Loans Go Scarce

Banks hesitate to lend for purchase of two wheelers. Such lending has been in decline for more than 15 percent over the past year, said officials from banks which are active in this segment (Kannan, et al., 2008). According to them, high rate of delinquency among customers and the recent norms on appointment of recovery agents have forced banks to go slow on it” Centurion Bank, which is a major player, has reduced lending for two-wheelers by almost 50 percent during 2007-08 (Singh, 2008).

Two wheeler Sales Dip

Two wheeler manufactures have already started feeling the heat. According to Mr. H.S. Goindi Senior Vice-President, TVS Motor, there is a 15 percent dip in sales on account of the tightening of credit norms alone (Kannan, et al., 2008).

Due to recovery problems on two wheeler advances, many banks and NBFCs have stopped financing two wheelers. This may follow suit for some category of
vehicles, if the vehicle dealers and manufacturers are not supportive enough to financiers.

2.9.2 Will Truck Finance give Banks the Mileage?

Traditionally the backyard of non-banking finance companies, the commercial vehicle lending business has a few new entrants—a few private and foreign banks namely HDFC Bank, ICICI Bank and Citibank through Citi-Corp, the NBFC arm of the Citi group (Mohandas and Vageesh, 2002).

Banks can definitely offer lower rates, thanks to their low cost of funds plus the whole gamut of banking services to fleet operators. But do banks have the required expertise to survive in this rugged terrain? On lending to fleet operators owning less than six vehicles, banks can fulfil their priority sector lending requirements. Banks, however, insist that they are in this segment with a business proposition in mind. Yet, there are words of caution from those familiar with this business. "Car financing may be something that banks are familiar with, but truck financing is a different ballgame altogether", says Mr. P.S. Balasubramaniam, Managing Director, Investment Trust of India Ltd. Repayments may not be the easiest to extract in this business. Income of fleet operators tends to be erratic at times, since it is dependent on another business. Repair and maintenance work of the vehicles may also lead to diversion of money, explains Mr. Balasubramaniam. The new entrants in the business may have to deal with fleet owners who may not have a bank account, leave alone a balance sheet!

However, NBFCs do not deny being affected by the competition. Banks do lack the reach that NBFCs thrive on, especially in remote areas. Conceding that
banks have a competitive advantage of cheaper funds, Mr. V. George, Managing Director, India Cements Capital and Finance, adds that this may be neutralized by their higher administrative and salary costs as well as the faster lending and recovery mechanism of NBFCs. This is how the NBFCs are surviving in the midst of heavy competition from banking companies.

2.9.3 Those Who Do Not Follow up on Time
What really bothers is bad follow up. Communication is very important in any business, particularly in finance. One can lose out on opportunities and business if communication with the buyers is suffering due to emails not having been answered on time. Timing is everything in business and communication is a major part of that. Orders are lost because someone didn’t follow up with the buyer. The entire business of not answering emails on time is nothing but sheer callousness (Chawla, 2004). The author is highlighting the importance of good follow up and communication. Follow up and proper communication is very important in managing receivables in NBFCs.

2.9.4 Used Car Loans Important Financial Products
In today’s competitive loan environment used car loans are much easier to find than they have been. In the auto industry, it is generally easier to find good car loans for new cars as the lender is less concerned about uncertainty as to the car’s history. Loan brokers have made it easy for car buyers because of their ability to quickly access loan products from their large collection of provider relationships. Car buyers have the ability to go to a motor loan specialist website, enter basic information about their needs, and receive car loan quotes based on their needs (Rix, 2008). Used car loans are available at reasonable rates in today’s market. Thanks to generally low interest rates in most loan
markets. Lenders realizing that the borrowers have more access to loans now than ever before, feel pressured to offer more competitive rates to compete for loan business.

2.9.5 Recovery Agents Learn to Behave, Courtesy SC

"Hello, good morning, sir! This is 'Nitin' calling on behalf of Bank. Can I please get some time later today with you to discuss your overdue car loan, sir?"

Don't pinch if one get such a call early in the day after having missed a couple of instalments of car loan. The caller may well be one of the 'recovery agents' who has undergone a 100-hour training meant to transform him from burly, uncivilised rowdy into a soft-spoken gentleman! (Athavale, 2008).

"These boys with education hardly up to SSC level knew just one thing - recover money by hook or by crook from defaulters," says Prakash Patki, general manager of Genesis Academy of Banking and Finance, which is among the 25 institutions, and the only one in Pune, accredited nationally by the Indian Institute of Banking and Finance (IIBF).

They are paid on the basis of the money they manage to get back; as a result, they don't care about the method they use to twist the defaulter's arm.

The high handed means of these agents, who have the tacit support of the banks that employ them, had led to serious incidents, including a defaulter committing suicide, Patki says, explaining the immediate background in which the supreme court directed the Reserve Bank of India to define norms for the training of recovery agents of banks, financial institutions and non banking finance companies.
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2.10 NBFC Deposits

Regulation is forcing debt investors to depend more and more on the government, banks and mutual funds. The proposed phase-out of NBFC deposits will only exacerbate the situation. Declining liquidity would, however, counteract these measures and could offer a better deal for investors (Krishnamurthy, 2004).

RBI is aiming to keep NBFCs outside the purview of access to public deposits. Apart from the authors commend it is likely to corpus various other problems

1. Increase in black money as certain investors are sure to be diverted to unauthorised money lending both for investment and loan
2. More and more NBFCs will choose the bond route as already happening.

2.10.1 RBI Modifies Deposit Norms for NBFCs- Companies with NOF of Rs. 200 lakh ought to freeze their deposits

The RBI has asked NBFCs with net owned funds of less than Rs.200 lakh to freeze their deposits at current levels.

In a notification, the apex bank has also directed asset finance companies (AFCs), having a minimum investment grade credit rating and CRAR (capital-to-risk assets ratio) of 12 percent, to bring down public deposits to a level that is 1.5 times their NOF. In the case of other NBFCs, the RBI wants them to bring their public deposits to a level equal to their NOF by March 31, 2009 (The Hindu, 2008).

2.10.1 RBI Bars Sahara India Financial from Accepting Public Deposits

Sahara India Financial Corporation (SIFCL), the largest deposit-taking non-banking finance company in the country, has been barred by the Reserve Bank
of India from accepting public deposits with immediate effect (Business Line, 2008).

SIFCL, the country's largest residuary NBFC, got a reprieve on Thursday after it managed to get a stay on the ban imposed on it by the Reserve Bank of India (Seetharaman, 2008).

The government of Uttar Pradesh (UP) wrote to the Reserve Bank of India (RBI) on June 4, seeking explanation as to what was being done to protect the interests of investors of Sahara group's para-banking company, SIFCL (Shivakumar, 2008).

In a temporary relief for SIFCL, the Supreme Court asked the RBI to give a fresh hearing to the company, while keeping in abeyance the RBI's June 4 order that refrained the Sahara arm from accepting fresh deposits from the public (The Telegraph, 2008).

In a climb down, the Reserve Bank of India has revoked the ban on Sahara India Financial Corporation, the residuary non banking finance company (RNBC), saying it can now accept deposits that mature on or before June 30, 2011 (Seetharaman and Rebello, 2008).

With this liberalized direction of RBI the 'Sahara' may amaze deposit, with them hereafter with the maturity by June 2011. Instead of giving blanket permission RBI should have suggested for a staggered maturity (for fresh deposit collection) at least from end of 2008 onwards. Now what is going to happen is a financial crunch for Sahara in June 2011.
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2.11 Regulatory Framework

Banks may no longer be able to resort to strong-arm techniques for loan recovery. The draft guidelines issued by the Reserve Bank of India suggest that banks should use the forum of Lok Adalat for the recovery of personal loans, credit card loans or housing loans of less than Rs.10 lakh. Recently, some banks have been in the spotlight for alleged harassment of their customers by recovery agents. In order to have a legal recourse for recovery of loans, Indian Banks’ Association had earlier suggested having special fast track courts on the lines of Lok Adalat. The IBA has set up a working group in order to study the various possibilities for loan recovery. Countries such as the UK and the US have special fast track courts, which deal with cases pertaining to recovery and repossession. Unlikely we do not have such an arrangement.

Banks should not sell their NPAs at a price lower than the net present value arrived in a manner mentioned by the Reserve Bank of India, said a notification from the apex bank. Such provisions are naturally to be extended to NBFCs also.

Recovery of bank loan has become speedier and easier after the enactment of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, according to the Chairperson Debts Recovery Appellate Tribunal, Southern Region. Justice K. Ganaparakasam. Sadly in spite of big hue and cry by NBFCs and their associations for extending the act to them, no move to that direction has taken place. This may be due to the lesser degree of regulatory control over NBFCs by RBI in comparison to banks, as well almost every NBFC in the country is in private sector and they have no direct rule in discharging the sovereign function of the country.
2.11.1 Recovery Agents: Guidelines may Open a Pandora's Box:-

And it may impinge on the autonomy of banks or inhibit their efforts

Repayment and recovery are not the two sides of the same coin. Repayment is voluntary and done in stipulated time. Recovery is needed when there is no repayment. Recovery always implies an element of coercion and pressure. The million dollar question is where to draw a line between the acceptable and avoidable! Informing the borrowers of the details of the recovery agents (RAs) is certainly desirable to avoid unauthorised and unscrupulous persons entering the arena or adopting any unsavoury methods for recovery. It would help eliminate possible impersonation and frauds too. It can be made mandatory. Recovery targets and incentives can't be altogether avoided. The success rate in any recovery effort is in a way linked to subtle pressure and offer of a carrot, particularly in case of outside agents. The terms and conditions of the contract are best left to the banks. What however needs to be emphasized is adherence to the rule of law and avoidance of intimidation and questionable methods, rather than prescribe a straight jacket document (Murty, 2007).

Banks and NBFC may have to make a provision for recording the calls made by recovery agents to customers and vice versa, according to the second draft guidelines on recovery agents issued by the RBI. Banks may also have to place an updated list of recovery agents on their Web site and conduct periodical verification of the antecedents of employees of recovery agents, which may include verification through police. While the revised guidelines may allow banks to continue recovery proceedings if the borrower continuously makes frivolous or vexatious complaints, they can also utilize the services of a credit counsellor if the case of a particular borrower deserves sympathetic consideration, said the draft guidelines (Business Line, 2008). Banks may be permitted to tie up with
the Indian Institute of Banking and Finance and other training colleges to that
every recovery agent passes the examination conducted by IIBF in a year.
Similar arrangements are necessary for NBFCs.

2.11.2 Frauds- Future Approach towards Monitoring of Frauds in NBFCs

Incidence of frauds in NBFCs is a matter of concern. While the primary
responsibility for preventing frauds lies with NBFCs themselves, a reporting
system for frauds is prescribed by RBI and this is to be adopted by them as and
when need arises. It is possible that frauds are, at times, detected in NBFCs
long after their perpetration. NBFCs should, therefore, ensure that a reporting
system is in place so that frauds are reported without any delay. NBFCs should
fix staff accountability irrespective of delays in reporting of fraud cases to the
Reserve Bank.

NBFCs should follow the following guidelines for reporting of frauds such as
unauthorized credit facilities extended by the NBFC for illegal gratification,
negligence and cash shortages, cheating, forgery, etc. to the State Police
authorities.

(a) In dealing with cases of fraud/embezzlement, NBFCs should not merely
be actuated by the necessity of recovering expeditiously the amount
involved, but should also be motivated by public interest and the need for
ensuring that the guilty persons do not go unpunished.

(b) Therefore, as a general rule, the following cases should invariably be
referred to the State Police.

(i) Cases of fraud involving an amount of Rs. 1 lakh and above,
    committed by outsiders on their own and/or with the connivance of
    NBFC staff/officers.
(ii) Cases of fraud committed by NBFC employees, when it involves NBFC funds exceeding Rs. 10,000.

It is true that fraud too takes place in NBFCs with and without the connivance of NBFC officials. Moral code of ethics and conduct is essential for NBFC employees to reduce frauds if not totally preventing it.

Banks should adopt legal path for all sorts of debt recovery and should be more transparent in terms of distributing loans, said the RBI. The RBI has received several complaints from public against using muscle power and rude behaviour used by recovery agents (Ahmed, 2007).

2.12 Non Performing Assets (NPA)

Non performing asset means an asset or an account of borrower, which has been classified by a bank or financial institution as substandard, doubtful or loss asset, in accordance with the directions or guidelines relating to asset classification issued by RBI. RBI has different set of regulatory frame work both for banking and non banking financial institutions. Prudential norms issued for non banking finance companies by RBI also deals with the norms for their NPA. NPA is derived out of non payment of interest or principal by borrowers which are overdue for certain period. Provisioning and write offs are part of prudential norms as notified on 2nd January 1998 and immediate amendment on 31 January 1998 (on the hue and cry of the NBFCs and their associations) and subsequent amendments thereafter.

Prudential Norms

Pursuant to the recommendations of the Narasimham Committee and Shah Committee for the first time the RBI had prescribed with effect from 1st April 1993
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Prudential norms for all types of financial companies with net owned funds on Rs. 50 lakh and above which had to be compulsory registered with. Further, in public interest to regulate the credit system to the advantage of the country, in exercise of powers conferred by Section 45 J(a) of the amended RBI Act, 1934, in 1997, RBI issued directions with effect from 2nd January 1998 (Notification No. DFC.115/DG(SPT) 198 dt. January 2, 1998). The prudential norms described related to (1) income recognition (2) accounting standards (3) asset classification (4) provisioning for loan and advances (bad and doubtful assets) norms for NPA (5) capital adequacy ratio (6) concentration of credit and investments, etc.

Economic wealth is perhaps being frittered away without any attempt to find out whether it can be reactivated to generate returns. The concept of non-performing assets has become the scourge of quite a few banks and NBFCs which are trying out various methods to deal with the problem. But what are the factors that have made assets non-performing? Was the financing done on time in keeping with the performance projections assumed and accepted for the purpose of funding? If not, non-accrual of income at the expected time creates a certain cost not earlier envisaged in the funding pattern. This often has snowball effect. Was the financing done to the required level, or was part-funding released in tune with the available sanctioning powers of the authority concerned? It would then be futile to expect 'X' level of performance, which would pre-suppose 'Y' level of funding, when only a percentage of 'Y' was made available. Was the funding given as per requirements of the venture? For example, under-financing of capital expenditure could result in working capital being diverted for capital expenditure-financial indiscipline, no doubt, but where should the blame lie? (Radhakrishnan, 2006).
Diversion of funds do happen in vehicle finance in NBFCs by delivery of low variance of vehicles with the connivance of dealers or mediators.

This results in overfunding and ultimately ending up in receivable problems. Before extreme steps are initiated for recovery of dues, has a viability exercise been carried out to assess the potential of the unit in difficulty to turn around? Is there any certification or confirmation in a bank that the exercise mentioned in the previous point has been carried out in respect of each of the accounts put under recovery proceedings, and the non viability established? Such a certification is as important as that relating to whether the listing out of the NPAs has been properly done to include all such accounts, and needs to be examined at all levels and by all connected agencies, whether inside the bank, auditors (statutory/concurrent/ internal), regulators, with as much keenness as the classification of NPAs (Radhakrishnan, 2006).

Even while bank managements claim to have initiated stringent measures to reduce the NPA level, the unions contend that the real and full extent of NPAs were being masqueraded by various methods. Every bank makes huge provision for NPAs in the form of allowing concessions, interest waiver, compromise settlement, corporate debt restructuring, etc. This exercise results in lowering the NPA, and not in actual recovery. If serious steps are taken to recover the dues, there would be no dearth of capital in banks. It is seen that even the employees unions are concerned about the state off affairs of recovery and write offs.

2.12.1 Recovery Ratings of NPAs

Recovery rating is a process of assessing the extent and possibility of recovery from a defaulted asset or NPA. Distressed or non performing asses can now have a better market with the credit rating agencies offering to rate such assets.
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The rating agency will assign the rating on the basis of the possibility and extent
of recovery from a defaulted or non performing asset through its recovery rating
mechanism (Kannan, 2007).

2.13 High Handedness of Recovery Men

At the time of entering into a banking transaction, customers, generally worry
about a few matters, mostly are:

1. Misuse of customer information and records
2. Unnecessary harassment by recovery agents

A genuine customer need not worry about these matters as the Reserve Bank of
India, Indian Banking Association and courts have explicitly provided some
guidelines in these matters.

In case of any grievance, the customer can approach any regulatory body for
resolution of grievance. RBI has specifically provided that all banks/NBFC will
be held responsible not only for their own actions but also the actions of their
agents i.e., DMAs (distributed multi-agent system) or franchisee or agent with any
other name. So these guidelines apply to bank/NBFC and their agents (Shah,
2006).

2.13.1 Debt Collection through Agency

Bank/NBFC can outsource debt collection work by appointing an agency. It shall
ensure that all recovery agents must carry a letter in the name of an individual or
an agency authorizing them to undertake debut collection work. Preferably, a
person employed in such agency shall be issued an identity card that is to be
carried at the time of debt collection work. Hence, customer can check
authorization letter and identify card to verify authority of person to deal in the
matter (Shah, 2006).
All written communications sent by agency should contain name and contact details of concerned officer. Agent shall contact customer within 7.00 am to 7.00 pm only and interact in civil manner. Calls and visits for debt collection are to be avoided when the customer is in the grip of a tragic occurrence. Bank or its agent shall not resort to any kind of threat or harassment to anyone for debt collection. Word 'anyone' includes customer, his family members, friends, colleagues or referee. Bank or its agent shall not pass any false or misleading information with intention to humiliate anyone publicly (Shah, 2006).

Article explains the rights of the borrowers of banking and non banking finance companies. The question of collection agency itself crop up only when borrowers are chronic defaulters. There are some NBFCs who are totally out sourcing the collection mechanism, without handling themselves at least the soft part of the work at initial stages. This is where the pinch is more for the casual defaulters, where agencies do not have soft mechanism or there is no responsibility to maintain good relationships. Slow process of judiciary in our country and the so called social responsibility attitude of judiciary towards defaulters are the major reasons for the oppressive measures adopted for the recovery by the financiers.

2.13.2 Recovery by Force

It is heartening to note that the RBI, in its mid-term review of monetary policy (2007), has indicated that it would not take a very strong view and even stringent action if bank's agents use force to recover loan overdues. A private sector bank is running ads featuring a prominent film hero staging it will treat the customers with respect and that it has mandated that agents follow the code of conduct.
But the ground reality is that nobody can control the agents who, in their greed to earn hefty commissions, often use all methods, including force, to recover the dues. Dr. Reddy (RBI, Governor) has put it very nicely while replying to a question by a reporter whether he would consider a ban on recovery agents: “We are hoping that our threat would work” I hope, the RBI will take its intent to the logical conclusion and severely reprimand the top officials of any banks that indulge in such practices, apart from any other stringent action (Narayanan, 2007).

2.13.3 Arm of the Law is Stronger than Muscle Power

Many people do not borrow money from banks and financial institutions for genuine purpose. For example, some take loan on the pretext of investing in agriculture. But the money is spent for some unproductive purpose. Loans are at times spent even for luxuries. This makes repayment more difficult. Loans are given to undeserving people. Banks and financial institutions then try to recover the amount, sometimes resorting to harassment. This is natural because it is a question of their very existence. They cannot just forgo the amount. But tyrannical means have to be avoided. For that, loans should be paid in instalments after verifying that the amount given as first instalment is spent for the purpose for which it is given. If the investment is for a genuine purpose, the bank can be sure that the borrower will repay the amount. If there is real loss due to unforeseen reasons, the government should intervene and write off the amount in genuine cases (Paily, 2007).

2.13.4 A Chronicle of Excesses by Loan Recovery Agents in India

More than a dozen recovery agents, riding on bikes forced Someshwari Prasad, a famous lawyer to stop his car. Prasad was held at gunpoint, slapped and made
to pay up. The only reason Prasad was mistreated because he was yet to pay the last instalment of his loan, which was a sum of Rs. 6500.

Vikas Porwal a resident of Ujjain who had taken a loan for a Toyota Qualis and defaulted on two repayments was abducted and held hostage at a bank premises by recovery agents. Later police raided the bank and charged the recovery agents with abduction.

Jitendra Singh a resident of Eldeco Colony, was traveling in his financed Santro car when he was intercepted by four motorcycle born recovery agents and asked him to part with the car keys. According to police they fired in the air and also looted some cash from Jitendra. These agents forcibly took a cheque and an amount of Rs. 5500 from him. Ashish, Jitendra’s brother who was also traveling with him, raised the alarm and police came to their rescue. The agents were nabbed and a case of abduction was filed against them.

Harinder Singh, a senior citizen who resides in Chandigarh was threatened by recovery agents who were having a fictitious arrest warrant against his name. They used it to collect a payment of Rs. 14,300 for a default, which Harinder claimed that he had never committed. The bank later vindicated Harinder’s stand and stated that no money was due and hence no demand for the money ought to have been made. However, when asked about how the bank’s recovery agents were able to file legal proceedings for recovery, every concerned official skirted the responsibility. Harinder was surprised on how it was possible that some persons might have obtained the customer’s name, credit card number, phone number, the amount allegedly due and falsely represented to be a police officer and a lawyer, respectively, and benefited the bank by using the threat of arrest details, without the connivance of bank officials.

Dheeraj Jain who had taken a two-wheeler loan, got an overdue payment notice from his bank, which gave him seven days to deposit the amount of Rs.1,889.
But just after two days four recovery agents stopped him near Mori Gate bus terminal and snatched his vehicle. It was later sold by the bank. When confronted in courts, the bank maintained that it used 'legal' means to repossess the vehicle but the court found it otherwise. The bank was asked to refund Rs 32,205 as the cost of the vehicle since the bank had sold it. A compensation of Rs 20,000 and Rs 1000 as the cost of litigation to Dheeraj was also slapped on the bank (Aggarwal, 2007).

In a bizarre incident of auto loan recovery turning into a personal vendetta, a bunch of former Bajaj Auto Finance Ltd beat up the cousin of a Dapodi resident who took a Rs 60,000 loan some 30 months ago. The reason being that 24-year-old Aniket Hazare had intervened a month ago when the recovery agents - then working with the auto finance company - had made a forceful entry in to the Hazare residence to recover the dues from cousin Tushar Hazare (Ananthapadmanabhan, 2008).

Situation in NBFCs vehicle finance recovery take place more or less in similar fashion. Only difference is that the recovery works in NBFCs are mainly handled by their own men because of which much of the problems are sorted out then and there except those that relating to some criminal activities connected to repossessing or hard core problems.

2.13.5 Stop using Muscle Power for Loan Recovery

Using hired goondas to recover loan amount is nothing but a clear-cut criminal activity and the Supreme Court has to compel banks and NBFCs to stop using muscle power for loan recovery.
In a recent case, Delhi State Consumer Dispute Redressal Commission has fined ICICI, India's largest private bank, a worth of Rs. 55 lakh for using muscle power to recover the loan amount from the defaulter. The consumer commission has criticised the bank for hiring the 'goondas', who had beaten the defaulter's friend unknowingly without trying to recognise the actual person. The Commission has also issued a notice to the Chief Executive Officer of the bank asking explanation for using muscle power to recover the loan, going against the direction of the Supreme Court, about the rules and regulation regarding loan recovery.

While imposing the fine of Rs. 55 lakh to the Bank, Justice J. D. Kapoor said, "We hold ICICI Bank guilty of the grossest kind of deficiency in service and unfair trade practice in breach of terms of contract of hire-purchase/loan agreement by seizing the vehicle illegally." (NI Wire, 2007).

2.13.6 Supreme Court Speaks for Bank Customers

India's legal system can work very slowly with the massive backlog of cases that it has. Due to this backlog and the time it could take to get a case heard, people resort to their own form of justice or get frustrated waiting for a resolution to the cases. In the case of a bank that has given a loan to a person and the person is delinquent about repaying the loan, the proper procedure is to institute a complaint and follows the proper legal procedure for recovering the loan. This would take a lot of time, and hence banks use the services of goons, loan recovery agents who use force, etc (Ashish, 2008).
2.14 Malaise of Indian Financial System: The Need for Reforms

The financial sector, worldwide is faced with adjustment problems of facing up to rapid changes in the environment. The Indian financial system cannot be immune to this universal phenomenon.

More importantly, the overall policy thrust was on ensuring that financial intermediaries fully met the credit demands for "productive purposes" and, therefore, the felt need of the borrower gained primacy over the viability of the financial intermediary and the safety and security of the saver was put at a discount. What was most disconcerting was the fact that borrowers defaulted on loans without inviting any adverse action. Lest this sound like a denigration of the Indian system but this was a world-wide phenomenon. In the context of the increasing fragility of the financial system, globally, there emerged in the eighties the now famous Basle prudential norms.

It is recognized that recovery of NPAs is not an easy task and the sheer attrition of time results in an accretion to NPAs as loans are down-graded on the asset classification ladder. There is a general perception, reinforced by the global rating agencies, that actual NPAs are higher than indicated by the numbers and there is at least anecdotal evidence of ever greening (Tarapore, 2000).

2.14.1 Financial Performance and Diversification Strategy of Indian Business Groups

During periods of low competition in the Indian economy (1987-91), profitability and net profit margins were negatively related to degree of product diversification. During 1991-95, a period of high growth rates for business groups post-liberalization, it was found that profitability, net profit margins and sales
turnover were negatively related to a group’s product scope. In 1995-99, a period of high competition from industrial deregulation, we found that growth and sales turnover of business groups were negatively related to their diversification levels. The results in the later periods also seem to be influenced by the capital market’s preference for focused business groups. So, the differences among the performance indicators across sub-periods apparently exhibit the influence of diverse competitive factors and economic characteristics prevailing during the three sub periods (Kakani, 2002).

NBFCs are popular because of their added advantage over banking institutions in terms of high customer orientation, lower transaction costs, quick decision-making, easy registrations, lesser regulations and higher flexibility. Flexibility in their structure also allows NBFCs to un-bundle services provided by banks and market the components on a competitive basis. These distinctive features armed with economic liberalization contributed to great proliferation of NBFCs activities in India (Nisar and Aziz, 2004).

New generation NBFCs are trying to capture through allied financial services- a departure from their traditional asset financing (vehicle financing) as competition kills the existing players. New players are trying to establish through different routes.

In early March 2007, Reliance Capital surprised the market with an announcement that it was entering the microfinance segment— it said it would lend to microfinance institutions (MFIs) that would then advance money to self-help groups and poor people at the grassroots level. On the face of it, this initiative wasn’t novel, except that it came from a NBFC in a segment that most banks are still reluctant to enter.
2.14.2 New Kids on the Block

Several large business houses are entering the NBFC segment. Apart from the more traditional loans business, the following emerging segments attract NBFCs.

Insurance: In June 2000, RBI allowed NBFCs to enter the insurance business.

Credit Cards: In July 2004, the apex bank allowed NBFCs to launch their own credit cards, either on their own or in association with another NBFC or scheduled commercial bank.

Distribution of Mutual Funds Products: During 2006-07, RBI permitted NBFCs to distribute mutual funds products as agents of MFs.

Money Changing and Money Transfer: In 2002, RBI included the money changing and money transfer business in the list of businesses that NBFCs could carry on.

According to Gagan Banga (CEO, Indiabulls Financial Services, 2008) their business model is independent of whether they get a banking license.

They have already seen momentum in building up their financial services business" (Pankaj Razdan, 2008, Deputy CEO, Aditya Birla Financial Services)

Their (NBFC’s) larger presence in semi-urban and rural areas gives them an edge over private sector banks" (Atul Pande, 2008, MD, Cholamandalam DBS Finance).

NBFCs are now looking at the financial services business in a much more holistic manner" (Praveen Kadle, 2008, CEO, Tata Capital).

Now the latest hot news in June 2008 is that “Magma Shrachi to finance vehicle market” Vehicle industry shall witness a new financier in the coming few month.

One of the biggest non banking finance companies, Magma Shrachi Ltd. is in talks with various auto companies for their vehicle finances. Magma Shrachi is
eyeing a bigger market share of the vehicle finance market in India. It has already signed tie-ups with General Motors, Hyundai and Mahindra. It already has a tie-up with Suzuki to finance their 2,40,000 cars annually.

Magma Shrachi is one of the biggest growing financial companies in India. It currently has 161 branches across the country and 3974 employees. It had been able to show 20 percent growth in its commercial vehicle segment in the past year in spite of considerable show down in the sales of new trucks. It now aims to achieve penetration in the non traditional urban market to boost its passenger car financing volumes (Satish, 2008).

The article highlights on the increasing competition in non banking finance companies, especially in vehicle financing. On the one hand, competition in vehicle financing will continue to increase because of the market dynamics and on the other, restrictions on the recovery method and procedures will also increase because of the intervention of RBI as well as various courts from time to time. All these clearly spells that there is no easy cake walk solution to the problems of NBFCs.