IJAER/December - 2012/Volume-1/Issue-4 ISSN: 2278-9677

International Journal of Arts & Education Research

NON BANKING FINANCIAL COMPANIES IN INDIA: PROBLEMS AND SUGGESTIONS

Dr. Shailendra Bhushan Sharma
Head, Department of Management, Noida College of Physical Education, Dadri,
Distt. - G.B. Nagar, U.P.

Lokesh Goel
Research Scholar, Sai Nath University, Ranchi, Jharkhand

INTRODUCTION:

The activities of non-banking financial companies (NBFCs) in India have undergone qualitative changes over the years through functional specialization. The role of NBFCs as, effective financial intermediaries has been well recognized as they have inherent ability to take quicker decisions, assume greater risks and customize their services and charges more according to the needs of the clients. In India considerable growth has taken place in the non-banking financial sector in recent years. Over a period of time they are successful in rendering a wide range of services. Initially intended to cater to the needs of savers and investors, NBFCs later on developed into institutions that can provide services similar to banks. In India several factors have contributed to the growth of NBFCs. This article focuses on the problems faced by the NBFCs and also suggests solutions for these problems.

PROBLEMS BEFORE NON BANKING FINANCE COMPANIES:

Rigorous Regulatory Framework: Just like banks NBFCs are required to be registered with RBI, follow stringent prudential norms prescribed by RBI in the matters of capital adequacy, credit/investment norms, asset-liability management, income recognition, accounting standards, asset classification, provisioning for NPA and several disclosure requirements. Besides this, RBI also supervises the functioning of NBFCs by conducting annual on-site audits through its official. Such a rigorous regulatory framework ensures that NBFCs function properly and follow all the guidelines of RBI. Thus in all respect the monitoring of NBFCs is similar to or in some case more stringent than banks.

High Cost of Funds: Slow industrial growth, stiff competition with NBFCs as well as with banking sector, small balance sheet size results in high cost of fund and low asset profile, non performing assets. A majority of NBFCs were not able to face the pressure created on and were wiped out. However, since FY 2001-02, there has been significant improvement in the business model of existing NBFCs with improvement in overall business environment. NBFCs have been able to expand their resource profile by diversifying the funding avenues. Further a strict control on asset quality and overheads, coupled with use of innovative borrowing tools such as securitization has resulted in improved profitability of NBFCs.

Decline of NBFCs: The stringent controls by RBI as well as increasing competition from the rejuvenated banking sector had an adverse impact on NBFCs. Most of the smaller NBFCs could not withstand the pressure and were closed down. The overall NBFC sector, except RNBCs, which are large with a broad business mix, recorded losses.

Unfair Competition: The reach of public sector banks is unparalleled in India. In addition, their cost of funds is the lowest. Their entry into the market for financing commercial vehicles, cars, two-wheelers and consumer durables can upset the NBFCs applecart. For now, the public sector banks are making an impact in housing finance, but their entry into other segments of retail finance may be only a matter of time.

Sense of Insecurity among Depositors: The depositors of these companies are subject to extreme insecurity is clear from the fact that: (i) Bulks of their loans are unsecured and are given to very risky enterprises and hence their charging high rates of interest. (ii) The loans, though given for short periods, can be and are renewed frequently and thus become long-term loans. As there is no exchange of communication between different companies, it is possible for a person or party to borrow from more than one finance company. (ii) The deposits of the public with the finance companies are not protected by the Deposit Insurance Corporation.

NBFCs have been working under a complex web of directives and guidelines formulated from time to time. Inevitably, some of the directives are viewed by NBFCs as being formulated in arbitrary manner and at odds with practical realities.

SUGGESTIONS:

Speeding up the Certification of Registration: Applications for Certification of Registration (CoR) and then allows them to accept deposits. The process of CoR is lengthy which should be made expeditious. The RBI should take steps to speed up the reform process in the functioning of NBFC sector along prudent lines. For further development of this sector, emphasis should be placed on formation of a Self Regulatory Organization (SRO), particularly for the benefit of smaller NBFCs.

Submission of Returns: NBFCs are required to submit periodic control returns to RBI. In order to inculcate a sense of discipline in this sector, action should be taken' against NBFCs for non-submission of returns. RBI should impose penalties as provided for in the Reserve Bank of India Act, 1934 as also launch court proceedings, besides considering cancellation of the CoR of NBFCs having public deposits of Rs. 50 crore and above., in case of default in the submission of returns. The above stipulation in respect of the size of NBFCs (i.e., Rs. 50 crore and above) should be progressively reduced over time to ensure that as far as possible, al! NBFCS submit periodic returns on a timely basis.

Provision of Cheaper Finance: The Reserve Bank of India (RBI) should consider options to make cheaper finance available to the non-banking finance companies (NBFCS) including a Separate line of credit for bank finance backed by government securities or AAA rated Commercial Paper (CP).

Relaxation in Prudential Norms: The Central Bank should review the various restrictions on placing bank funds with NBFCs and should also relax prudential ceilings.

Reduction in Systemic Risk: The fund requirement is acute for three or four large NBFCs that have grown rapidly in recent times and accumulated large exposures in the stock market, real estate, commodities and retail financing. The only reason such entities need assistance is that they pose a systemic risk. The problem is acute not because there is a dearth of liquidity but because banks are unwilling to lend to NBFCs. They feel that these institutions lend to the real estate sector and for stock market transactions, both of which may face a downturn. Therefore, the loans may turn bad at a time when liquidity is an issue.

Grant of Bridge Loans: At present, a bank's exposure to a single NBFC is currently capped at 10 per cent of banks' capital funds and 15 per cent for an NBFC engaged in asset financing companies. NBFCs should also be allowed to make bridge loans. Shares and debentures should he accepted as collateral for secured loans granted to NBFCs.

Truck Financing should be given the status of Priority Sector Lending: In a sense the NBEC sector is the best route to finance trucks and other motor vehicles. This is because in their area they are market savvy and have the ability to monitor them and recover the money lent to them. Already in truck financing the large domestic and foreign banks are using the NBPCs as channel partners. Hence, the public sector banks should finance the NBPCs on a wholesale basis and they, in turn, could fund the non-corporate sectors in u chain of retailing credit and recovery functions.

Strengthening the Professionalism of the NBFC: The NBFC sector should be strengthened through professionalism by providing education and training to employees. In the financial affairs qualified MBA's and Chartered Accountants should be employed.

Integrating the Financial Markets: It is required for us to recast the architecture of the Indian financial system if it has to ensure growth of the economy along with adequate availability of credit to the fastest growing sectors of the economy. The aggregate monetary policy of the RBI can be achieved if and only if the role of NBFCs, is recognized, encouraged and integrated in the financial system.

Guidelines on Fair Practices Code: NBFCs are advised to prescribe the board guidelines on fair practices that are to be framed and approved by boards of directors of all non-banking financial companies. The fair practices code so framed and approved by the board of directors should be published and disseminated on the website of the company for the information of the public.

Prior Public Notice about Change in Management: NBFCs, including RNBCs, are advised that whenever there is change of management and control of NBFCs, prior public notice should be given 30 days before effecting the sale, or transfer of the ownership by sale of shares, or transfer of control, or by way of amalgamation/merger of an NBFC with another NBFC or a non affairs qualified MBA's and Chartered Accountants should be employed and integrated in the financial system. Public, financial company by the NBFC and also by the transferor, or the transferee.

Cover for Public Deposits - Creation of Floating Charge on Liquid Assets: All NBFCs accepting/holding public deposits should create floating charge on the statutory liquid assets invested in terms of section 4S-IB of the RBI Act, 1934, in favour of their depositors. In view of the practical difficulties expressed by the NBFCs in creating the charge on the statutory liquid assets in favour of a large number of depositors, it was decided in January, 2007 that NBFCs accepting/holding public deposits may create the floating charge on the statutory liquid assets, in favour of their depositors, through the mechanism of Trust Deed'. The charge is required to be registered with the Registrar of Companies and the information in this regard is required to be furnished to the trustees and the Reserve Bank.

Guidelines on Corporate Governance: Corporate governance is the key to protect the interests of the stakeholders in the corporate sector. NBFCs are no exception as they too are corporate entities. In order to enable NBFCs to adopt best practices and ensure greater transparency in their operations, the code of governance should be fixed in relation to construction of audit, nomination and risk management committees, disclosure and transparency and connected lending relationship.

Problem of Excessive Interest Charged by NBFCs: NBFCs should lay down appropriate internal principles and procedures in determining interest rates and processing and other charges, even though interest rates are not regulated by the Reserve Bank. NBFCs are advised to keep in view the guidelines on Fair Practice Code about transparency in respect of terms and conditions of loans.

Setting up of Refinance Institutions: It is strongly recommended that the Government should set-up a Refinance Institution tor financing NBFCs like NABARD for refinancing the commercial banks**.**

NBFCs to be covered under SRFAESI Act, 2002: It is highly unfortunate that there is no Law/regulation prevailing in the country today which facilitates recovery of our dues from our borrowers. Prudence tells us that timely recovery of our dues will ensure timely payment of all our liabilities including public deposits.

It is recommended that the provisions of SRFAESI Act, 2002 should also be made applicable to NBFCS also. NPAs are a problem common to all the lenders in the financial sector whether they are Banks, Financial Institutions of NBFCs. Moreover, prudential norms for asset classification, income recognition, provisions etc. are applicable to NBFCs at par with those for Banks and FIs. Under these circumstances, it is suggested that the benefits of Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SRFAESI), 2002 should be extended to NBFCs.

CONCLUSION:

NBFCs have been playing a very important role both from the macroeconomic perspective and the structure of the Indian financial system. NBFCs are the perfect or even better alternatives to the conventional Banks for meeting various financial requirements of a business enterprise. They offer quick and efficient services without making one to go through the complex rigmarole of conventional banking formalities. However to survive and to constantly grow, NBFCs have to focus on their core strengths while improving on weaknesses. They will have to be very dynamic and constantly endeavour to search for new products and services in order to survive in this ever competitive financial market.

REFERENCES:

1. http://www.iba.org.in/
2. http://www.moneycontrol.co./
3. http://www.rbi.org.in/home.aspx
4. http://www.economist.com/index.html
5. Nabhi's Law relating to Non Banking Financial Companies, A Nabhi Publication, 1994, pp. 1,3, 5.
6. Machiraju H.R., "Indian Financial System", Vikas Publishing House Pv. Limited, 1998, p.7.1
7. Mahesh Thakkar, Director General, Finance Industry Development Council, Pre Budget Memorandum", 2007-08.
8. Seema Saggar, "Financial Performance of Leasing Companies, During the Quinquennium Ending I989-90", Reserve Bank of India: Occasional Papers, Vol. 16, No. 3 September 95, pp. 223-236.