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ANALYSING THE BANKING SEVICES IN INDIA IN TERMS OF NON-FINACIAL BANKING

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ABSTRACT

This paper investigates the difference in the indicators of the profitability of firms in the Non-Banking Financial Institutions (NBFIs) and banking industry of Bangladesh. Profitability of a financial institution basically depends on its Operating Efficiency, Capital Structure, Fixed Charges & Income and Liquidity Position. The current research is an endeavor to find out the key profitability indicator variables and their influence over Net Profit. Moreover it tries to find out the discrepancy between the profitability indicators of these two industries. Statistical techniques of simple and multiple regressions have been used to determine the relationships between variables. The analysis results show that among the independent variables the Liquidity Condition and Operating Efficiency have a considerable relationship with Profitability of Bank and Non-Bank sector.

Keywords: - Finance, Economy, Profit, Banking, Profitability

I. INTRODUCTION

A major driver of growth in an emerging economy such as India is sustained investment by the private sector. For triggering as well as sustaining investments, a critical factor is stable availability of credit. Historically in the Indian economy, credit has grown faster than gross domestic product (GDP). The ratio between the growth of bank credit and the growth of nominal GDP ranged from 1 to 2 and averaged 1.42 from 1962 to 2019. For most of this period, banks constituted the predominant source of credit in the formal economy whereas bond markets and nonbank lenders accounted for a relatively smaller share of credit. Since 2014, credit growth in the banking sector has been lackluster largely because of burgeoning nonperforming assets (NPAs) on the balance sheets of banks, especially public sector banks (PSBs). Some part of the shortfall in credit from the banking sector was compensated by flows of credit from nonbanking financial companies (NBFCs) until 2018. In September 2018, Infrastructure Leasing & Financial Services Limited (IL&FS), a prominent NBFC, defaulted on its debt obligations. This event precipitated a crisis that engulfed the entire NBFC sector. Consequently, in the first half of fiscal year 2020 (FY2020, ended in March 2020), there was a sharp decline in incremental credit from both commercial banks and NBFCs. Even as the NBFC sector was struggling to recover from the 2018 crisis, the country was hit by another massive shock in the form of the coronavirus

(COVID-19) pandemic, which began spreading rapidly in India from March 2020. In response to the outbreak of the highly contagious disease, the Government of India announced a nationwide lockdown from 25 March 2020, which continued until June 2020. During this period, most economic activity came to an abrupt halt, nonessential businesses were suspended, and essential businesses got heavily curtailed. This shock has had an adverse impact on the NBFC sector in terms of constrained availability of funding as well as growth in NPAs.

While much has been written about the NPA problems of the Indian banking sector after 2008 (e.g., Sengupta and Vardhan 2017 and 2019b), less work has been done to study the NBFC sector and document the structural issues that this sector faces in light of the 2018 crisis as well as the ongoing pandemic-related crisis.

The objectives of this paper are to (i) analyze the evolution of the NBFC sector in India in the past two decades, particularly in the context of its role in commercial credit; (ii) understand the 2018 crisis episode; (iii) briefly discuss the potential impact of the COVID-19 pandemic on this sector; and (iv) draw lessons from these events to evaluate the future of NBFCs. The paper attempts to understand the advantages and disadvantages of the business model of NBFCs, and the drivers of their rapid rise and subsequent challenges.

There are typically two models of providing credit: (i) intermediated credit that flows through the balance sheet of financial institutions such as banks and NBFCs, and (ii) market credit that flows through the bond market (sometimes through risk pass-through vehicles such as mutual funds). Historically, commercial credit in India has primarily relied on financial institutions because bond markets have not had the necessary liquidity and depth.

II. COMPARISON OF NONBANKING FINANCIAL COMPANIES WITH COMMERCIAL BANKS

In the model of credit where savings are intermediated through the balance sheets of financial institutions, the two most important players in India are commercial banks and NBFCs. To analyze the growth and subsequent crisis of the NBFC sector in the late 2010s, it is important to understand the differences and similarities between NBFCs and commercial banks, both with regard to their business models as well as the regulatory frameworks that they are subject to.

The most crucial difference in the business models of banks and NBFCs is that while banks accept public deposits, most NBFCs (i.e., NBFCs-ND) cannot. Household savings are the largest and cheapest source of funding in India. Since NBFCs cannot access household savings through deposits, their cost of funding is structurally higher than banks. Even when adjusted for the cost of maintaining reserves (the cash reserve ratio and statutory liquidity ratio), banks enjoy an advantage of 50 to 150 basis points as compared with NBFCs in pricing credit, largely because

of their access to low-cost deposits. Given the relative disadvantages on the funding side, NBFCs provide credit primarily to those segments where they can compete with banks. These segments, which are inaccessible or unattractive for commercial banks, are where NBFCs can build specific capabilities that enable them to overcome their inherent funding cost disadvantage.

Banks may be constrained from serving a particular segment owing to regulatory restrictions imposed by the RBI. One such restriction relates to how much banks can lend against shares as collateral; consequently, NBFCs dominate the “loan against share” business. Some segments that operate in the informal cash economy are inaccessible to commercial banks and hence are not served by banks. A good example is small truck fleet operators whose business is primarily conducted in cash. When they need financing for new and used trucks, these operators often lack the documentation needed to obtain credit from banks. In these cases, banks’ inability to underwrite loans based on informal information acts to the advantage of NBFCs. Sectors with limited access to banks also include commercial vehicles (especially used commercial vehicles), construction equipment used by small contractors, and agricultural implements. NBFCs have developed deep knowledge and skills in dealing with customers in these sectors. Other segments have been unattractive to banks for reasons of high operating costs, lower credit risk appetite, or inability to assess credit risk in the absence of documented financial information of customers (as in the case of self-employed customers).

The competitive dynamic segments that have a strong presence of NBFCs include the following:

(i) Commercial vehicle financing, including used commercial vehicles;

(ii) Credit against gold collateral;

(iii) Affordable housing loans;

(iv) Consumer durable loans;

(v) Loans against shares and margin financing for stock market traders; and

(vi) Loans against property for micro and small business owners as well as construction and real estate development firms.

III. Non-Banking Financial Institution

An institution which collects funds from people in different forms & places them in financial assets, such as deposits, bonds etc. It also lends loans and advances to needy people and institutions. NBFIs are registered under company act and must be approved by RBI as Non-Banking Financial Institution.

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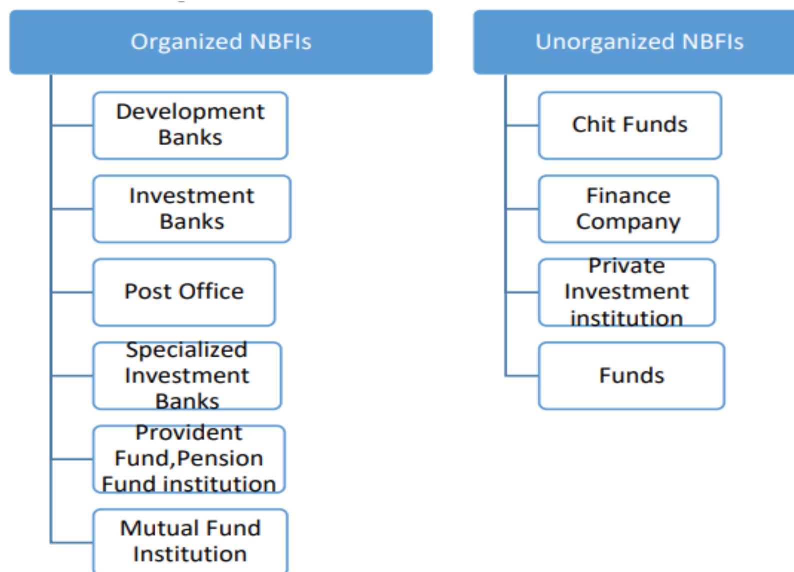
Features of NBFIs:

- These are small entities in terms of their size and scope
- These are less capital intensive
- Easy availability of loans
- Loan Rescheduling option is available (converting short term loan to long term)
- NBFIs fulfills several needs of the economy (Financial assistance to agriculture, industry, trade etc.)
- They conduct their activities independently
- Efficiency in work
- It involves risk of recovery of loans from borrowers

IV. Classification of Non-Banking Financial Institutions:



1. Industrial Development Bank of India (IDBI)

Industrial Development Bank of India was established in 1964 as a wholly owned subsidiary of Reserve Bank of India. The bank was to act as an apex institution coordinating functions of all the financial institutions into a single integrated movement of development banking.

The ownership of IDBI was transferred to Central government on February 16, 1976. It is now working as state owned autonomous corporation.

2. Industrial Finance Corporation of India (IFCI)

The Government of India established the IFCI on July 1st, 1948, as the first development financial institution in the country to cater to the long term finance needs of the industrial sector. It was established under the INDUSTRIAL FINANCE CORPORATION ACT 1948. The IFCI was the first specialized financial institution set up in India to provide finance to large industries in India.

3. State Financial Corporation's (SFC's)

The State Finance Corporation Act was passed in 1951, which authorized each state & union territory to set up a State Finance Corporation. Punjab was the first state to set up a corporation under the act in 1953. Karnataka State Financial Corporation was established in the year 1956, to meet the long term financial needs of small &medium scale industries in the state of Karnataka. Currently KSFC is located in Bengaluru. Similarly, Kerala SFC, Haryana SFC, Odisha SFC, AP SFC etc. are functioning in India.

4. Export & Import Bank (EXIM Bank)

The Export- Import bank of India, also known as EXIM Bank, was set up in January, 1982 but commenced its operations from 1st March, 1982. EXIM Bank is the top most banking institution in the field of financing foreign trade of India. EXIM Bank looks after the export finance function of IDBI. The head quarter of the bank is located in Mumbai, India.

5. Industrial Credit & Investment Corporation of India (ICICI)

ICICI was established in 1994 as a wholly owned subsidiary. It is into the area of Investment, Credit, Insurance, capital market etc. It has both Banking and Non-Banking domain in India.

V. CONCLUSION

The banking means accepting the deposits and giving loans but there is a list of additional business activities which are allowed for a bank. Further, the dealing in goods or immovable property is prohibited for a banking company. In India, no company can carry on banking business unless it holds a license issued from the RBI.

The regulator supervises them in order to ensure a sound banking system for the economy and particularly the safety of depositors' interest. Not less than 51per cent of the total number

of directors are required to be professionally qualified. The areas of their specialization are listed in the act and they are mainly related to the accountancy and commerce.

The banks do not maintain journal for accounting but transactions are posted directly in ledger with the vouchers. The vouchers are slips prepared by customers or bank staff. This slip system for ledger posting is suitable for banks.

A bank cannot hold an asset other than of his own use but it can possess as security and further in case of failure in repayment of loan it can transact in course of its final disposal. But such assets should be disposed of within seven years.

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