# THE ROLE OF NBFCS IN THE INDIAN ECONOMY

*Ms. Teena Saini[[1]](#footnote-1) & Dr. Kavita Dive[[2]](#footnote-2)*

# Abstract

NBFCs (Non-Banking Financial Companies) play an important role in promoting inclusive growth in the country, by catering to the diverse financial needs of bank excluded customers. Further, NBFCs often take lead role in providing innovative financial services to Micro, Small, and Medium Enterprises (MSMEs) most suitable to their business requirements. NBFCs do play a critical role in participating in the development of an economy by providing a fillip to transportation, employment generation, wealth creation, bank credit in rural segments and to support financially weaker sections of the society. Emergency services like financial assistance and guidance is also provided to the customers in the matters pertaining to insurance. NBFCs are financial intermediaries engaged in the business of accepting deposits delivering credit and play an important role in channelizing the scarce financial resources to capital formation. They supplement the role of the banking sector in meeting the increasing financial needs of the corporate sector, delivering credit to the **unorganized sector** and to small local borrowers. However, they do not include services related to agriculture activity, industrial activity, sale, purchase or construction of immovable property. In India, despite being different from banks, NBFC are bound by the **Indian banking industry** rules and regulations. NBFC focuses on business related to loans and advances, acquisition of **shares**, stock, bonds, **debentures**, securities issued by government or local authority or other securities of like marketable nature, leasing, hire-purchase, insurance business, chit business. The banking sector would always be the most important sector in the field of business because of its credibility in supporting manufacturing, infrastructural development and even being the backbone for the common man's money. But despite this, the role of NBFCs is critical and their presence in a country would only boost the economy in the right direction.

**KEYWORDS:** *Non- Banking Financial Institutions, New Economic Policy, Financial Institutions, Reserve Bank of India, Marketing Securities*

# Introduction

A Non-Banking Financial Company is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of shares/ stocks/ bonds/ debentures/ securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods or providing any services and sale/ purchase/ construction of immovable property.[[3]](#footnote-3)

A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking financial company. In the global society, the Non-Banking Financial Companies has played an important role on the overall economic development. The concept of a non-banking financing company in India was shown particularly after introduction of the New Economic Policy in the year 1991.

Since then the post nineties era has seen a vast development in the financial sector in India, more than any other sector. The financial system comprises of financial institutions, financial instruments and financial markets that provide an effective payment and credit system and thereby facilitate channelizing of funds from savers to the investors of the economy. The components of the Indian Financial System have gone through a remarkable transformation in these years. In India, a considerable and substantial growth has taken place in the financial sector in last two decades[[4]](#footnote-4). The overall financial system has witnessed a complete turnaround on all possible parameters, some of them are:

1. There has been privatization of the financial institutions,

2. The statutory financial institutions undergoing a change of their role in the overall economy as a whole,

3. Most importantly offering of new and new financial products and services commonly known as financial innovations to the investors as well as market participants.

The government of India has put their maximum efforts to de-regulate the banking system on the line of global requirement and credit activities have been promoted by financing. The banking system has undergone huge reforms with the coming up on private as well as foreign banks, a more than ever scrutiny also resulting into regulatory reforms with the securitization bill.

The capital markets have seen a more than 100% increase in the companies listed on stock exchanges, more mature movements than before, increased investor awareness, new trading dynamics as well as launch of derivatives, positive developmental regulations amongst others. The money markets have seen an increased participation more than ever resulting and more financial institutions that have come up in the post nineties era resulting into variety of products and huge volume of transactions.

One of the new and very major developments in this period was the coming up of non-banking financial companies. Non-banking financial companies have been a subject of vast attention since the nineties.

The activities of financial institutions are different from the activities of non-financial business organizations. The financial institutions deal with financial assets such as deposits, loans, securities and other financial assets. On the other hand, non-financial business organizations deal with real assets such as machinery, equipment, stocks of goods, real estate and so on. The activities of different financial institutions may be either specialized or they may overlap.

The basis of classification of financial institutions can be stated as:

According to such classification, financial institutions are divided into various groups.

They are:

a) Regulatory

b) Intermediaries

c) Non-intermediaries, and

d) Others

Banking and non-banking institutions came under same group of financial intermediaries. The term ‘*intermediaries*’ indicates intermediate between savers and investors. They lend money and also mobilize savings. Their liabilities are associated with savers, while their assets are related with investors or borrowers. Banking and non-banking institutions have similarity in respect of certain activities. The distinction between banks and non-banking financial institutions is mainly in the nature of the liabilities of the two and in the structure of their assets.

For example, hire-purchase finance companies confine their operations mainly to the financing of transport operators and consumer credit while housing finance companies make loans for housing purpose. Sometimes, the differences are not demarcated as the banks are also making advances in fields like transport and consumer credit.

But banking institutions have special power to participate in the economy’s payment mechanism, that is they provide transactions services and they can create deposits. Banking institutions, subject to legal reserve requirements, can advance credit by creating claims against themselves while non-banking institutions can lend only out of resource put at their disposal by the savers.

Meaning of Non-banking finance company is a business entity whether incorporated under the Companies Act, 1956 or not which devotes its resources in providing financial services to the society by having various descriptions which are distinct from and none compared to normal banking services.

In other words, non-banking financial companies are those companies and institutions, which accept non-cheque able deposits for the purpose of lending or investment. The activities of Non- Banking Financial Companies are directly regulated and controlled by the Reserve Bank of India (RBI).

Non-Banking Financial Company means—

* + A financial institution which is a company.
  + A non-banking institution which is a company and has its own principles of business and the receiving of deposits, under any scheme or arrangement or other way.
  + Non- banking institution or class of such institutions, with the previous approval of the central Government and by notification in the official Gazette.

## How do NBFCs facilitate Economic Development?

#### 1.  Greater Employment Opportunities and Standard of Living

NBFCs help attain the objective of macroeconomic policies of creating more jobs in the country by promoting SMEs and private industries through lending them loans. This increase in new businesses consequently raises the demand for manpower and creates employment. Furthermore, the Purchasing Power Parity (PPP) of people rises and so does their standard of living.[[5]](#footnote-5)

#### 2.  Strengthening of Financial Market

The financial market relies heavily on Non-banking financial institutions for raising capital. The start-ups and small-sized businesses are dependent on funds offered by NBFCs and also in order to maintain liquidity. For an effective functioning and balance in the financial market, NBFCs play a significant role.

**3.  Supplying long-term credits**

Unlike the regular banks, NBFCs extend long-term credits to infrastructure, commerce and trade companies. The traditional banks expect timely, schedules and short-term repayment of loans that may not always suit the requirements of these industries. NBFCs, on the other hand, fund large projects and so promote economic growth. They also allow industries to participate in equity.

#### 4.  Mobilization of Funds

Non-banking financial companies help in rotation of resources, asset distribution and regulation of income to shape the economic development. They enable converting saving into investments and thus helps in the mobilisation of funds/resources in the economy.

#### 5.  Growth of National Income

As NBFCs aim to build capital for several industries – private and otherwise – they aid in accumulating a capital stock for the country. This directly adds on to the national income and results in the progression of Gross Domestic Product (GDP).[[6]](#footnote-6)

## Game Changers

**P Vijaya Bhaskar, ex – Executive Director, RBI, explained how NBFC companies are game-changers that are very important to the economy**

* **Size of sector:** The NBFC sector has grown considerably in the last few years despite the slowdown in the economy.
* **Growth:** In terms of year-over-year growth rate, the NBFC sector beat the banking sector in most years between 2006 and 2013. On an average, it grew 22% every year. This shows, it is contributing more to the economy every year.
* **Profitability:** NBFCs are more profitable than the banking sector because of lower costs. This helps them offer cheaper loans to customers. As a result, NBFCs' credit growth - the increase in the amount of money being lent to customers – is higher than that of the banking sector with more customers opting for NBFCs.
* **Infrastructure Lending:** NBFCs contribute largely to the economy by lending to infrastructure projects, which are very important to a developing country like India. Since they require large amount of funds, and earn profits only over a longer time-frame, these are riskier projects and deters banks from lending. In the last few years, NBFCs have contributed more to infrastructure lending than banks.
* **Promoting inclusive growth:** NBFCs cater to a wide variety of customers - both in urban and rural areas. They finance projects of small-scale companies, which is important for the growth in rural areas. They also provide small-ticket loans for affordable housing projects. All these helps promote inclusive growth in the country.

### NBFCs aid economic development in the following ways

* Mobilization of Resources - It converts savings into investments
* Capital Formation - Aids to increase capital stock of a company
* Provision of Long-term Credit and specialised Credit
* Aid in Employment Generation
* Help in development of Financial Markets
* Helps in Attracting Foreign Grants
* Helps in Breaking Vicious Circle of Poverty by serving as government's instrument

# Conclusion

To conclude, the Non-Banking Financial Companies are playing significant role in meeting financial requirements of the medium sized and small sized industries and development of Indian economy indirectly. The policies of Non-Banking Financial Companies are also providing investment security for the investors. It is highlighted that due to the regulations of the Reserve Bank of India, still the Non-Banking Financial Companies are not extending more credit.

It is suggested to the Non-Banking Financial Companies credit policy to reduce rate of interests, which helps to small enterprises to get loans for their different capital requirements. The review made above shows that the research in Non-Banking Financial Companies is not so progressive as many of the published research papers shows only basics of the Non-Banking Financial Companies and still it is essential to study the evaluate the performance of Non-Banking Financial Companies in India.

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