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NON BANKING FINANCIAL CORPORATIONS [CHALLENGES AND OPPORTUNITIES]

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ABSTRACT

Winds of change have engulfed the economy and the polity of India ever since 1991. The pseudo state capitalism of the Nehruvian era gave way to the pseudo free market capitalism of the Manmohan era, albeit both of a retarded variety. During this period two things happened. The gap between the haves and the have-nots has increased, (giving fuel to the fire of fundamentalism) and unemployment levels are rising (but no one wants to talk about it). Under such conditions talking of 8% annual economic growth without adequate provision for funds to flow into the entrepreneurial hands is absurd. The Non Banking Financial Companies hold the key to this dilemma. This paper argues that the key should be allowed to operate and turn the wheels of fortune. The quality of life will be enriched through democratisation of funds and as a result the lot of the common man will improve. The point is: do our leaders have the economic foresight and the political will to do so.

INTRODUCTION

Non-banking Financial Companies (NBFCs) are financial institutions that supplement the services offered by public and private banks. According to section 451 clause (f) of the RBI Act, a non-banking financial company is defined to mean "a financial institution which is a company; a non-banking institution which is a company and which has as its principal business the receiving of deposit under any scheme or arrangement or in any other manner, or lending in any manner, or any other non-banking institution notified by the Reserve Bank".

There are more than 37,500 NBFCs in India today. Many of these operate in district towns and have built a strong community of clients whom they are servicing. The several lakhs of depositors and shareholders base that NBFCs have built up over the decades shows their superior performance in customer service, recovery management and niche marketing capabilities. Some of the important NBFCs operating in India include Sundaram Finance, Lloyds Finance, Cholamandalam Investments, Ashok Leyland Finance etc. Their main areas of operations are servicing Hire Purchasing, Leasing, Investment, and Financing (like, auto financing). It is estimated that nearly 60 % of all trucks sold in India are through hire purchase schemes. Almost 99 % of second hand trucks and taxis exchange hands through NBFC support. 75 % of two-wheelers and 25% of white goods are sold with NBFC finance.

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CHALLENGES

In addition to the ethics and governance related impediments to free and fair functioning of NBFCs the following challenges and concerns remain to be faced.

1) Margin pressure-NBFCs are facing margin pressure due to rising interest rates. Since, its borrowings are mostly linked to G-sec yields, increase in the rates push funds cost upward, whilst a slower increase in lending rates due to competitive pressure may put margins under pressure, thereby impacting its profitability. Additionally, NBFCs mostly have insignificant exposure to the retail segment; it does not have access to low-cost deposits and high-yielding retail loans.
2) Competition from banks-As the infrastructure sector offers tremendous growth potential and offers tax breaks, banks have started shifting their focus to fund such projects. Banks unlike NBFCs have also got access to low-cost deposits, due to widespread operations in the form of retail deposits and thus can lend at competitive rates. However, NBFCs enjoy an advantage over banks in term of expert domain knowledge, project structuring skills and proved experience in infrastructure lending.
3) Government policy dependent-NBFCs profitability is directly linked to government policies and regulations. Any staggered decisions, policy reversals, mandatory lending to particular sectors, which may not be profitable, may impact the company's growth prospects.
4) The need of capital to grow-Given the strong growth rates in its business, we believe that NBFCs would have to require capital in order to fund its growth.

OPPORTUNITIES

The NBFC business model is highly customer centric with a deep perception of customer needs, presenting unique last mile credit delivery. The inherent advantages of NBFCs over banks, as well as government focus on making them more efficient, are not only attracting foreign banks but private equity players too. Foreign banks find NBFCs very attractive because such entities primarily target the consumer finance segment, which embodies a risk profile marked by high risk and high gains.

NBFC has to look forward to offer a complete financial advisory service for companies seeking to secure debt financing, raise equity capital, and buy or sell their businesses. This includes performing feasibility studies, pre-acquisition reviews, financial modeling, M&A due diligence, strategic planning, and business valuations; preparation of business plan documents, financing memorandums, and sellers memorandums; assisting in negotiation and helping to raise capital.

If the 8% per annum economic growth rate is to be realised then industry and business must be allowed to grow. For this it must have access to funds with relative ease. This is not happening perhaps because of bureaucratic hurdles. A gap between demand and supply has already emerged in the current credit market which is making it very difficult for many small and middle-market companies to obtain financing. This, at a time when businesses need greater access to capital to ride out the storm or to pursue the attractive strategic opportunities present in the current environment. Relationships are important in the financing community. NBFC has earned the respect of capable and aggressive top tier funding sources.

If the NBFC has to perform its role as the provider of funds its entire framework must be re-evaluated and this we have done using the model given below.

CONCLUSION

As we go forward from here, the most important point to remember is not past successes or present impediments but the future potential of strategic marketing of the NBFCs and making them target oriented in the new millennium. According to an April 2006 McKinsey India survey, rural India alone has the potential to become a US$500 billion market by the year 2020. It remains to be seen whether today's Non-Banking Financial Institutions have the tenacity, dexterity and wit to retain first mover advantage.

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