AN IMPACT STUDY OF ROLE OF NBFCs: NEW PATH OF DEVELOPMENT MSME BUSINESS IN INDIA

Sagar R. Shah
Assistant Professor
P. R. Pote (Patil) College of Engineering & Management, Amravati, India Email ID: - sagar889@rediffmail.com

Abstract

Non-banking financial companies (NBFCs) play a vital role in diversifying the financial sector, which is evident from the growing liquidity in markets and diversification of financial risks. This has given impetus to financial stability and made the sector more efficient. NBFCs have carved niche business areas for themselves within the financial sector space with innovative products and delivery systems like providing customized products, mostly at the customer's doorstep; processing applications within minutes; sanctioning loans at the click of a button and leveraging the FinTech ecosystem. Owing to a variety of constraints faced by the banking system in intensifying its lending activities, the role of NBFCs has become even more significant now. With the advantage of lower cost and deep connect with customers, NBFCs can adopt a robust underlying risk management framework which will indirectly promote entrepreneurship and create employment opportunities. Financial intermediaries like (NBFCs) have a definite and very important role in the financial sector, particularly in a developing economy like India. NBFCs 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. The NBFC sector has ontinuously played a critical role in encouraging growth of the Indian economy and hence needs to be nurtured appropriately. This research paper mainly highlights the role of NBFCs in promoting MSMEs growth in India. It also sets forth various analyze the role NBFC Finance to MSME and other sectorol growth the way forward.

Keywords: *Financial Sector, NBFCs, Inclusive Growth, Financial Services, MSMEs.*

1) Introduction:

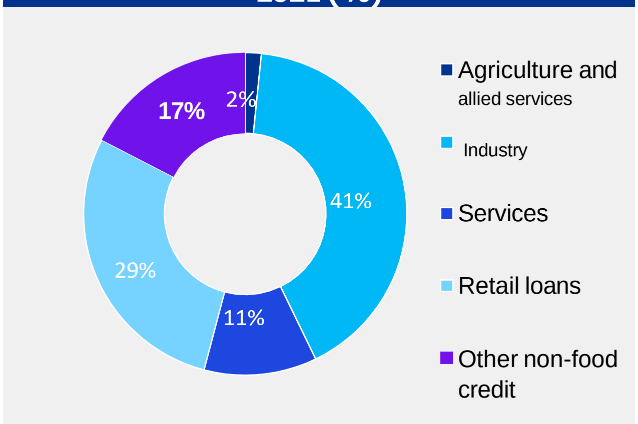
The emergence of new-age Non-Banking Financial Companies (NBFCs) is rapidly transforming he Indian lending ecosystem, introducing novel models that incorporate the best offerings of the world of fintech and conventional credit features, thereby enriching the protocols of enterprise lending and business loan prerequisite.

NBFCs have been a vital cornerstone of the Indian financial ecosystem as important financial intermediaries channelizing savings and investments, especially for small-scale and retail sectors as well as underserved areas and unbanked sectors of the Indian economy. Over the years, NBFCs have evolved given the extensive changes in the regulatory framework for NBFCs in India which have moved from simplified regulations to stringent and extensive regulations as well as towards rationalization per the currently revised NBFC regulatory framework. Given these high levels of regulation, NBFCs have also emerged as preferred options to meet credit needs since the low cost of operations has provided these NBFCs an edge over banks. (CII, 2022)

2) Review of Literature:

- Nandini evaluated the financial performance of NBFCs in India. The study revealed that, the growth, operational performance, financial soundness, asset quality of NBFCs improved over the years. The growth of NBFCs in niche segments of financial sector is even higher than banking sector.
- Hareesh has evaluated the financial performance of eight NBFCs –ND-SI working in Kerala during post sub-prime meltdown i.e. 2008-16. For the purpose of study he used the statistical techniques such as correlation and ordinary Least Square Regression. NBFCs are emerged as non-productive short term advances for householder's n the Kerala. The study found that banks policy to towards small scale industries led to growth of NBFCs in Kerala, but, rural banking policy has shown adverse impact on the NBFCs.
- Noor and his friends explored the conceptual

Sectoral split of NBFCs' credit in December 2021 (%) [1]



- **Fig 1**

- background of Basel III and investigated determinants of credit risk and interest rate risks during pre and post economic crisis i.e. 2002-15. The study has examined the impact of Basel III norms on the 36 listed banks in India. The empirical results witnessed that a positive relationship between capital adequacy requirement and gross non-performing assets and Net Interest Margin. Consequently, the analyst opined that this relationship may cause lower GDP in the future economy of India.
- Basappa has analyzed asset and liability management practices in regional rural banks during 2011-2015 with special reference to Karnataka Vikas Grammena Bank. In the study he examined the risk management practices of Karnataka bank in aspects of liquidity risk, interest rate risk and credit risk. The study observed unsatisfactory level of capital adequacy ratio Tier II compared to Tier I of KVGB. The study also found that significant variation between interest gap and asset- liability gap during the study period. However, maturity gaps for very short and short period reported negative in first three years and positive in next two years, in contest, long maturity gaps found positive gap during entire study period. This indicates that firm has good liquidity position during the study period.
- Rosy Karla has analyzed the performance of 20 selected asset based and core investment non-banking financial companies during 2006-2015. The study has observed the performance of selected NBFCS in terms of growth in physical assets. The study has observed gradual improvement in its assets and investment over study period which is a symbol for increase industry contribution in financial sector.

3) Objectives of the Study:

a) To study the growth of NBFC Sector.

b) To analyze the role NBFC Finance to MSME Sector.

c) To examine the role of NBFC developing economy.

4) Growth of NBFCs Sector in India:

With exposure towards banking as well as capital markets, NBFCs have emerged as an essential part of India's financial ecosystem over the past two decades. Over the years, NBFCs have become an important source of credit for low-income households and businesses that do not have collateral or sufficient credit profile for bank credit. Through wide network of branches, digitalization and innovative solutions, they have grown their presence among MSMEs and consumers, especially for financing vehicles, housing and gold. They all have actively embraced technology and digital tools to bring down the transaction costs, speed up the loan disbursal process and leverage alternate data and practices to improve risk assessment and underwriting. Some of them have also grown larger in size than many banks and have been one of the major stock outperformers.

Following a recent period of sluggish years amid liquidity stress, failure of major players and pandemic hit, Indian NBFCs have bounced back strongly with higher capital levels, reasonable stability in delinquency accounts and larger balance sheets.

Stronger risk assessment frameworks, government support, such as debt moratorium and liquidity enhancement measures, and broader economic revival have helped them tide through these challenges and pursue innovative strategies to meet evolving opportunities. They will play a major role in financing India's transition from the world's fifth largest to third largest economy by the end of this decade. (CII, 2022).

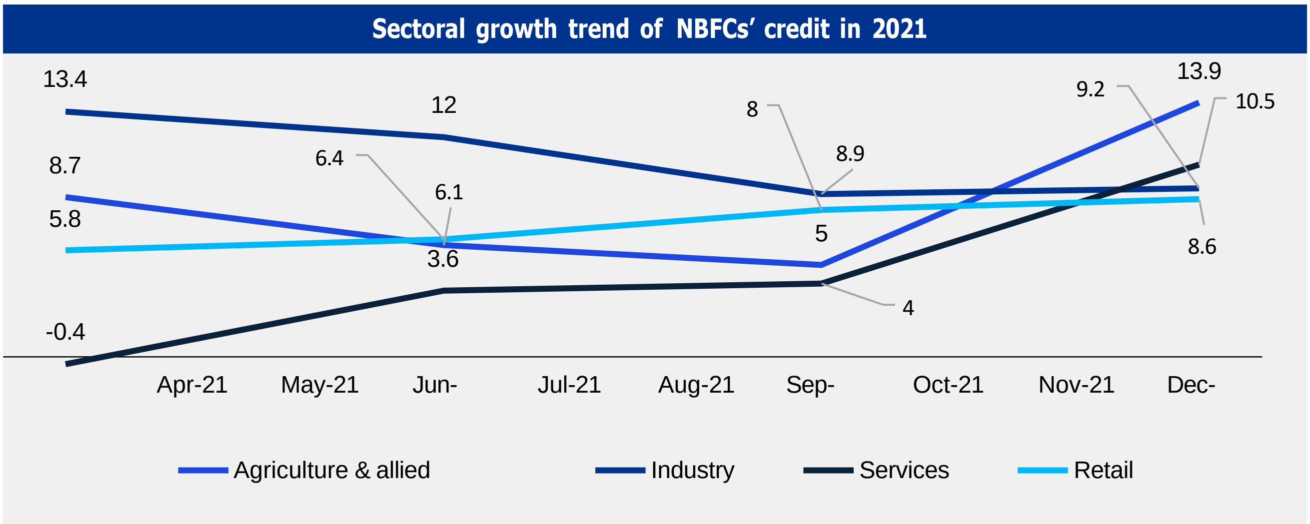


Fig: 2

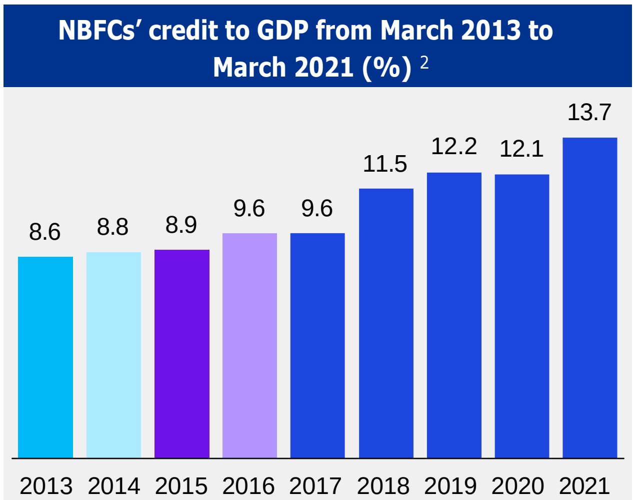


Fig: 3

Note: a. Fiscal year runs from April to March.

Source: 1.A Steady Ship in Choppy Waters: An Analysis of the NBFC Sector in Recent Times, RBI

2. Nonbanking financial companies (NBFCs) credit to GDP ratio fromfinancial year 2013 to 2021, Statista, accessed in November 2022

The growth of NBFCs in India has scaled substantial progress and has diversified their activities up to a large extent. The NBFCs have now created a passage connecting the less banked customers to the financial services paving the way for inclusive growth. The NBFC sector comprises financial institutions that provide certain banking and financial services without a banking license. These institutions are not permitted to accept demand deposits from the public.

They are not covered under the financial and state financial regulation. The RBI announced a small-scale- based framework for NBFC w.e.f Oct 22, 2022. The new framework comprises capital requirements, governance standards, prudence regulation, and other similar criteria. The growth of NBFCs in India is further classified based on the size of their assets and other marketable securities.

The operations of NBFCs have evolved over the past few years. A few larger NBFCs approached the scales of several private sector banks. Take a look at some of the major causes that influence the expansion of NBFCs in India -

Customized Solution

The working of NBFCs primarily focuses on a specific line of business leading to the development of the NBFC sector. The NBFCs modify their products to suit the requirements of a distinct consumer. It focuses on providing a satisfactory response to the demands. These developments are now leading to the growth of NBFCs in India through better non-standard pricing structure according to the product lines of the client profile and keeping a check on the lending risk.

Optimum use of technology

The NBFCs are customizing their credit assessment models. They are also focusing n streaming their business processes through means of technology. This up-gradation has resulted in an enhanced client experience. NBFCs use data analytics, artificial intelligence, and other cutting-edge technology. These developments help in building strong relationships with their target client segments.

Service to the underserved

NBFCs give priority to the unorganized and under-served portions of the economy. The frequent interaction prepares a carved out niche for the businesses in the NBFC sector. These developments assure last-mile delivery and improvement in client satisfaction.

Arrangements for co-lending

The growth of NBFCs in India has recently formed partnerships with several alternative lenders and commercial banks working on digital platforms. These modifications have led to considerable growth in their target customer base.

Better Connectivity

The NBFCs are now rendering their services to the Tier 2, Tier 3, and Tier 4 markets. They provide loans to the clients through several touch points and establish a connected channel experience. The multi-channel facilities of the NBFC sector are accompanied by 24*7 sales and service. These financial institutions have now developed new and innovative ways for the customers.

Better risk management

NBFCs adopt a robust and adaptable risk management model to focus on enhanced governance. They emphasize their lending's to the subprime customers and mitigate the regulator disadvantages as compared to the commercial bank lenders.

The future path for growth of NBFCs in India

The NBFCs shall be able to provide deposits, loans, and investment services to the clients. These developments may take place due to the successful collaborations between the NBFC and the payment banks, bill payment providers, and other such financial service providers. The growth of NBFCs in India can also exploit digital consumer data to provide better services in the current digital environment. The NBFCs should lookout for new ways to serve the clients in a better manner and build long-term relationships. (ESPECIA in News, 2022)

5) Bridging the Credit Gap:

NBFCs form the last-mile link in the supply chain of credit to low-income households and businesses, particularly those who are in the business of microfinance, financing of equipment, MSME business loans and the like. Their customers are those who cannot otherwise get loans from banks and for whom NBFCs have devised accessible ways to get capital.

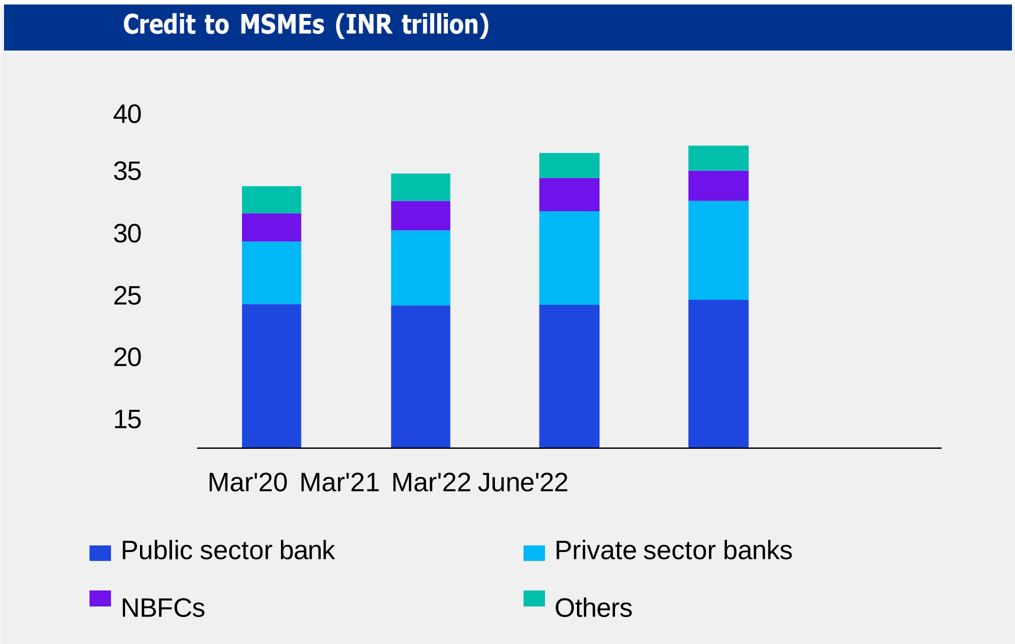
Digital lending has played a critical role in delivering financing solutions to last-mile borrowers. As of January 2022, there are more than 9,500 NBFCs registered with the Reserve Bank of India, many of which have adopted the fintech model.

Fintech in India is a burgeoning industry that has stayed well ahead of the global race in terms of adoption. The EY Global Fintech Adoption Index 2019 showed that fintech adoption in India had grown to 87% compared to the global rate of 73%. According to more recent reports, the country continues to hold its place of pride as the fastest growing fintech hub in Asia. While a large part of the industry is oriented towards B2C services at present, fintechs also present an enormous opportunity for B2B operations, especially when it comes to MSMEs. (Kinara Capital, 2022)

6) Role NBFC Finance to MSME Sector:

Non-banking financing companies (NBFCs) have been another major driver in pushing more credit to the MSME sector, especially in the vast unbanked pockets of the country. In addition to building a wide network of distribution channels, they have embraced digitalization of processes, leveraged technology for data analytics and adopted unconventional credit underwriting practices to meet the requirements of the small businesses.

Compared to banks, they have been more agile and have introduced personalized products and offerings based on the risk profiles and demands of different segments of the sector. NBFCs are also striking partnerships with fintech players, banks and alternative lenders to extend credit and bundled products for businesses. While the banks still dominate the flow of term loans to the sector, NBFCs have taken a lead in providing unsecured loans.



Source: Aggregate level data is sourced from Experian Credit Information Company of India Private LimitedFig: 5

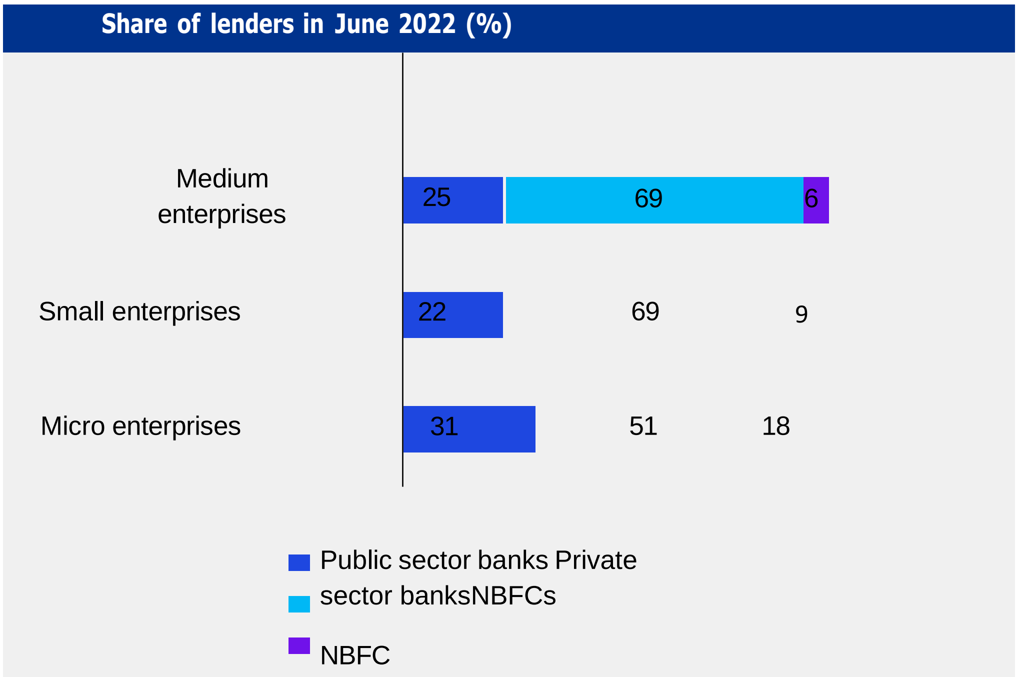


Fig: 4

Source: Share of lenders in June 2022, Experian, accessed in November 2022

7) NBFC Role in Developing the Economy:

The NBFC industry is evolving into a destination for all of a customer's financial needs. NBFCs are crucial to India's economic development since they serve as the key facilitator of the country's growth journey. Following are the key role played by NBFC in Economic Development:

- **Growth:** In terms of year-on-year (YoY) growth rate, the NBFC sector beat the banking sector in contributing to the economy every year. On an average, this segment grew by 22% every year, in its initial stages. Despite the slowdown in the economy and various setbacks faced in the last few years, the sector is still growing and enhancing operations.

- **Profitability:** NBFCs have been more profitable than the banking sector because of lower costs. This enabled them to offer cheaper credit to customers. As a result, the amount of money lent to customers by NBFCs is higher than that of the banking sector with more customers opting for NBFCs.

- **Enhancing the Financial Market:** An NBFC caters to the urban and rural poor companies and plays a complementary role in financial inclusion. These financial companies bring much-needed diversity to the market by diversifying the risks, increasing liquidity in the markets thereby bringing efficiency and promoting financial stability to the financial sector. They highlight the public issues of corporations as well as providing funds needed by the start-up companies as capital. The financial market is dependent on the functions that are taken care of by these lending companies.

- **Infrastructure Lending:** NBFCs by lending to infrastructure projects, contribute largely to the economy. This is very important for the growth of a developing country like India. The amount involved is quite large, the projects being risky, with no surety of returns, and profits occurring after a longer time- frame. These factors deter banks from financing these projects. Since their inception, NBFCs have contributed more to infrastructure lending than banks.

- **Promoting Inclusive Growth:** All the top NBFC in India 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. Microfinance provided by them plays an important role to attain stable financial inclusions. All these activities by the institution with an NBFC License help promote inclusive growth in the country.

- **Upliftment in the Employment Sector:** With the growth in operations of the small industries and businesses, the policies of NBFCs are uplifting the job situation. More opportunities for employment are arising with the influence of the NBFCs in the private as well as government sectors. The business activities in the private sector provide more employment opportunities and occupation practices. And NBFC play a key role in their growth and stability.

- **Raising the Standard of Living:** NBFCs collaborate with the government for the upliftment of the society. The NBFCs attract deposits from the general public and convert it into capital for industrial and other sectors for smooth economic development. The rise in businesses consequently raises the demand for workforce and creates employment opportunities raises the purchasing power of individuals and, subsequently, rising demands. This works to upgrade the living standards of a society. Also, foreign deposits are attracted to these financial institutions and support economic process and development. (How NBFC Play a Crucial Role in India’s Success Story, 2023)

8) Conclusion:

The NBFCs of India are unparalleled in terms of accessibility and flexibility in accessing resources. The NBFCs endure even the adverse times due to their combative nature and customized solutions. The NBFC sector is now transforming into a financial supermarket and serves as a one-stop financial destination. There is a need for increased efforts and tech disruptions to improve capital access, in order to bridge the credit gap in the MSME sector. The NBFC is leveraging its vast network of branches and executives to make last-mile borrowing smooth and accessible for its customers. Going forward, the sector is further expanding its footprint and continues to refine its technology to ensure the best outcomes for its MSME customers.

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