Non-Banking Financial Companies and Consumer Credit: Growth and Performance

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Abstract

The growth of NBFCs can be clearly attributed to their superior product lines, lower cost, broader and effective reach, robust risk management capabilities to check and control bad debts, and proper comprehension of their customer segments. Not only they have displayed success in their conventional citadel (passenger and commercial vehicle finance) but they have also managed to build significant assets under management (AUM) in the personal loan and housing finance sector which have been the bread and butter for retail banks. Moving ahead, the latent credit demand of an emerging India will permit NBFCs to bridge the gap, particularly where traditional banks have been cagey to serve.
KEYWORDS: consumer credit, financial performance and Growth rate

INTRODUCTION

Non-Banking Financial Companies (NBFCs) constitute a heterogeneous lot of privately owned ,small size financial intermediaries which provide a variety of services including Loans and Advances, Equipment Leasing, Hire purchase, Investments, Infrastructure lending, Microfinance and chit fund activities. These companies play an important role providing credit to the unorganized sector and to small borrowers to the local level. The role of NBFCs in transferring the funds from lenders to borrowers has been well recognized. The main advantages of these companies is Customer orientation and prompt provision of services, Concentration in the main financial centers, Attractive rate of return offered, Lower transactions cost of operations, Quick decision making ability, Simple sanction procedure and Flexibility and timeliness in meeting the credit needs of customers. On the account of this advantage, the NBFCs have in recent years grown size both in terms of numbers as well as the volume of business transaction. Primarily engaged in the retail banking, they face competition from banks and financial institutions. With increasing service sector activity in India, the NBFCs have been playing a critical role in providing credit.

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. 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.

Review of Literature

According to Samal and Panda (2012) NBFCs operations are becoming increasingly customer oriented. The demand for NBFCs offers one stop integrated financial services is well on the rise. The ability of NBFCs offer clients to access to several markets for different classes of financial instruments has become a valuable competitive edge .Convergence in the industry to cater the changing demographic expectations is now more than evident .NBFCs assurance and other forms of cross selling and strategic alliances will soon after the business dynamics of NBFCs and fund the process of consolidation for increased scope of business and revenue income.

According to Bala and Sanjoy(2009) NBFCs are financial entities that provide banking services without meeting the legal definition of banks .They are typically not allowed to take deposit from general public and hence have to seek other means of funding .NBFCs can reached the unorganized segments of society with their ability to provide innovative financial services .These entities play a crucial role in disbursing credit to rural sector, thus preventing the concentration of credit risk in banks. In urban area too, NBFCs focus on workers, traders, and stock brokers who are neglected by banks.

Prasanta- Paul (2011) has carried out a comparative study of some selected NBFCs in terms of its Financial Performance. The study applied different statistical tools like; arithmetic mean, standard deviation, coefficient of variation, correlation, and analysis of variance (ANOVA) to validate the findings of the study. Various kinds of financial ratios have also used to analyze the financial performance of the selected NBFCs. And the study concluded by saying that the selected companies differ significantly in terms of their financial performance indicators from one to another and there are no significant differences in the last five years in the management of financial performance but the companies have performed well in the last five years

Amritpatel and Gopalkalkoti (2010) mentioned that According to RBI ,the major reason for increase in overall household indebtedness to non- institutional source was a significant increase in the current farm expenditure and house hold expenditure for which household found it difficult to obtain loan from banks .In addition to that the cumbersome procedure of submitting various documents with loan applications and documentation process led to an average of 33 weeks taken by commercial banks to approve loans .

A study conducted by Kroszner (2010) on NBFCs elaborated that the robust growth and effective functioning of a financial system is vital for economic development. He argued that there is universal agreement that a well functioning financial system is necessary for a thriving modern economy. It is therefore, necessary to view NBFIs segment of financial system as a catalyst for economic growth and to provide proactive regulatory policy support for their contribution towards economic development.

Methodology

The study covers three broad segments of NBFCs and corresponding number of companies. Three segments are Housing Finance companies (HFCs), (18), Financial Services/ Investment companies: FS-I{173}, and Term Lending Companies : TLs {5}.The study use only secondary data analysis. Secondary data would be collected from Annual Reports of RBI, Journals, Various reports of different agencies and Articles published on various magazines.

Objective

1 To analyze the growth pattern of consumer credit of selected NBFCs functioning in India.

2 To study the financial performance of NBFCs functioning in India.

Figure 1 shows the number of NBFCs-ND-SI increased till 2014due to increased licenses given to these entities following notification of newer categories. Thereafter, there was a decline in their number mainly reflecting the increase in threshold asset size for defining NBFCs-ND-SI (Table 1). NBFCs-ND-SI have become significantly larger than NBFCs-D – their share in total assets of the two categories taken together was about 86 per cent in 2017.

Figure 1- Registration and cancellation of NBFCs

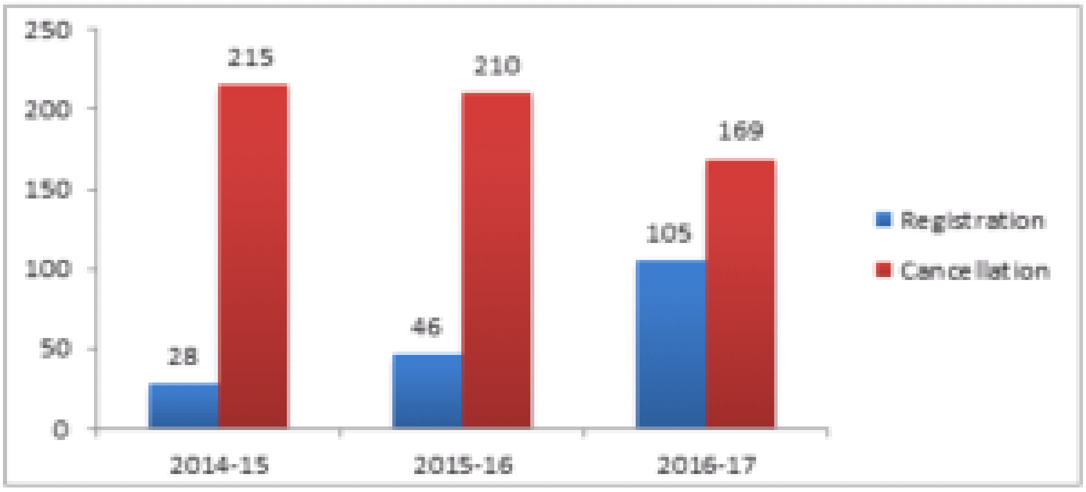
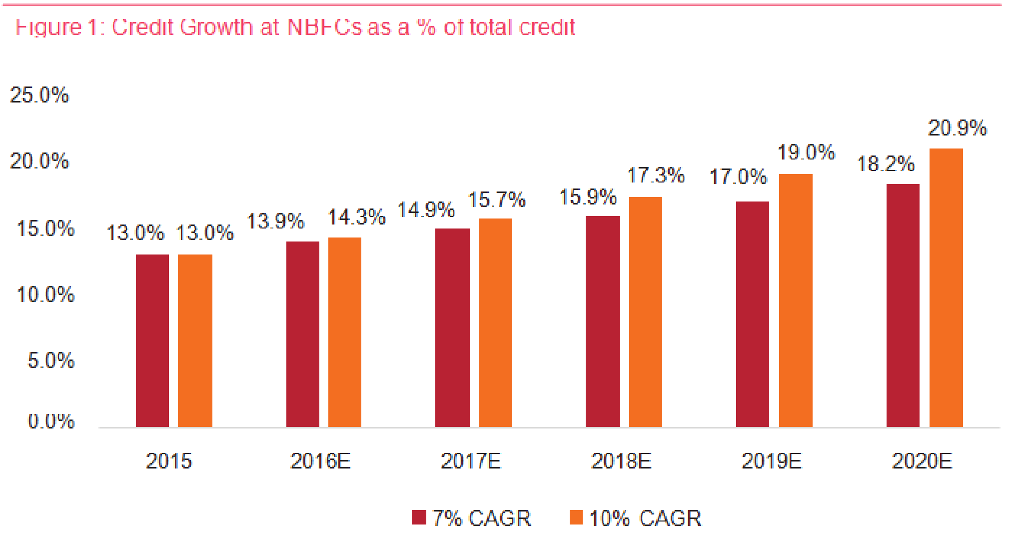


Figure 2 gives the expected credit growth of NBFC sector, if CAGR 7% the actual credit growth in the year 2015 was 13.0% and 10% CAGR the growth rate was 13.0%. The expected credit growth of NBFC sector, in 2020 the NBFC sector will grow if 7% CAGR will be 18.2 and if 10% CAGR the expected credit rate will be 20.9%.

Figure 2 Expected Credit Growth of NBFC Sector



Total credit disbursements of NBFCs

The study deals with the asset side of the balance sheet focusing on the credit granted by the NBFCs to the varied sectors to fund their requirements. The NBFC sector has traditionally funded both the industrial and the retail segments. The RBI study states that while industry has received about 2/3rd of the total credit by these companies, there has been a significant jump in the share of retail credit from 3.4% in FY15 to 17.7% in FY17.

Figure (3) shows that total credit disbursed by these sample companies under study and the growth in the total credit across the time period .The figure gives the total loans disbursed by the three segments across the given time frame. In the year 2018 (17.2) the maximum credit growth shown and least growth shown in 2013 (8.8).

Figure 3: Total outstanding credit (Rs. Lakhs crs) and growth in credit (%)

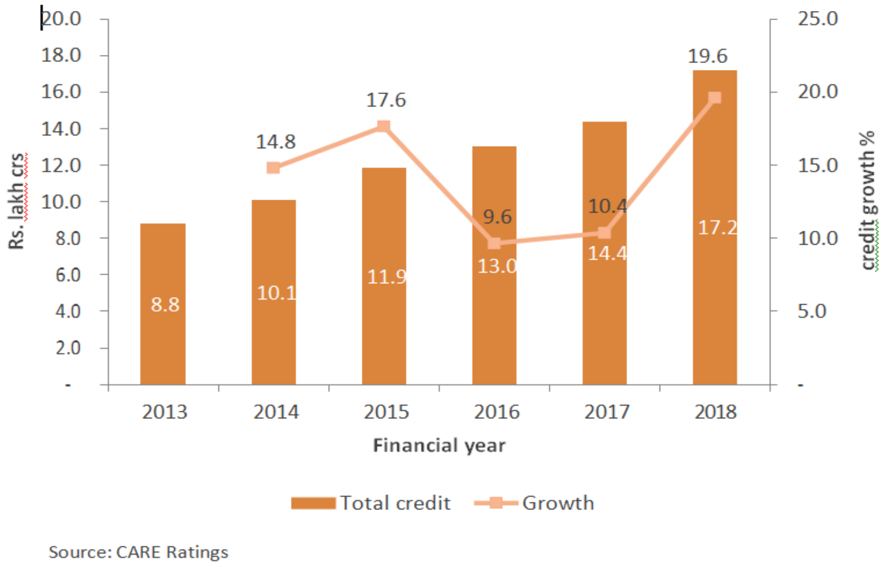


Figure 4 gives the share of total credit based on different segments i.e., Housing Finance companies (HFCs), Financial Services/ Investment companies: and Term Lending Companies: TLs

Figure 4: Division of the total credit based on different segments (Rs. Lakh crs)

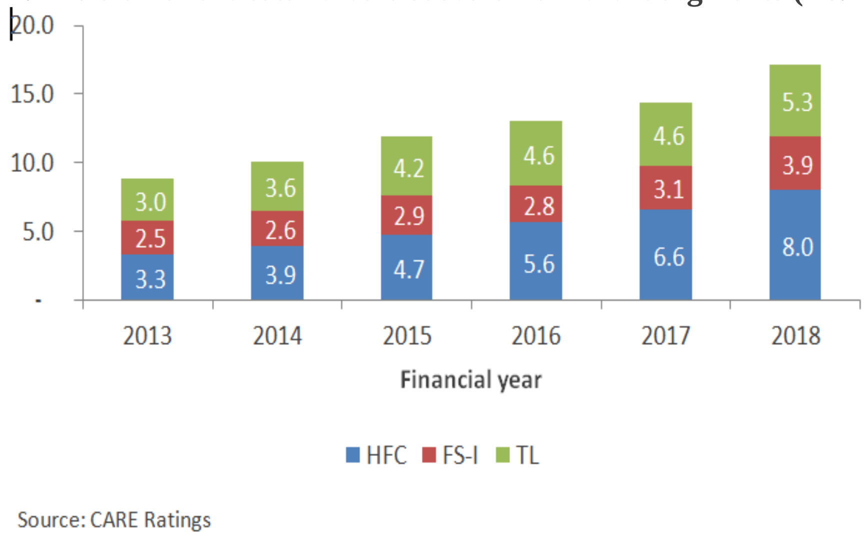
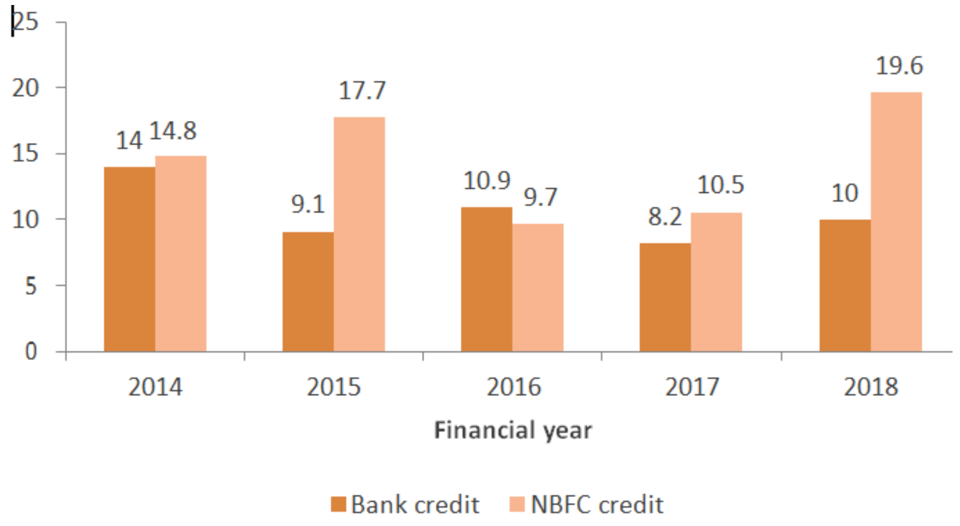


Figure 5 shows the bank credit growth and NBFC credit growth for the preceding 5 years to analyze the performance of the NBFC sector vis-vi s Banking sector. The charts show the sustained credit off-take in total NBFC sector credit during the previous 5 years. The total credit disbursed by the sample has been Rs. 17.2 lakh crs. This quantum of credit extended by the sample companies in the overall NBFC sector is around 20% of the bank credit of Rs. 86.3 lakh crs in FY18 and has increased from 16.7% in FY13.

The NBFC sector has witnessed a significant credit uptick of 19.6% in FY18 over a growth of 10.5% in FY17. The growth in FY18 has been significantly higher than the bank credit growth of 10% in FY18. The NBFC credit growth at double the rate than the bank credit growth is attributed to the banking system witnessing challenges such as adherence to capital adequacy norms, NPA, banks under the prompt correction action (PCA) and lower demand from manufacturing in particular. Out of the last 5 years, NBFC credit has been higher than the bank credit in 4 years.

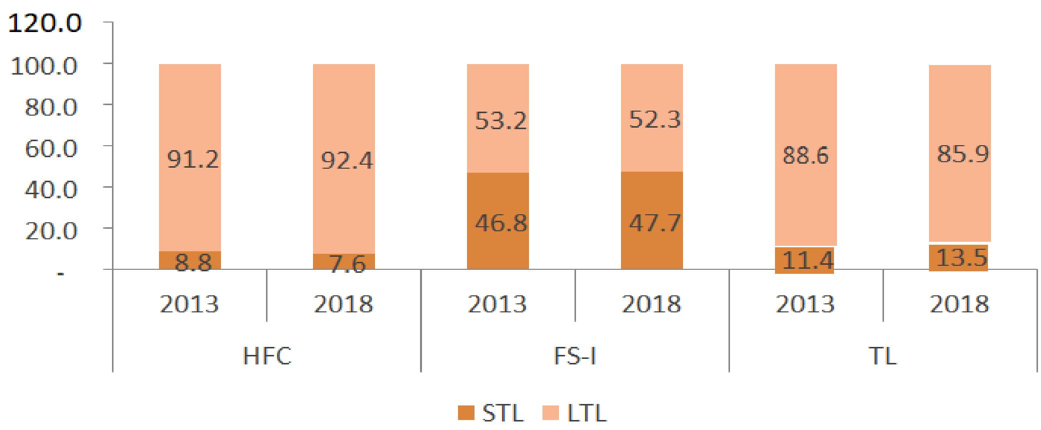
Figure 5: Bank credit growth vs. NBFC credit growth (y-o-y % change)



Source: CARE Ratings, CMIE

Figure 6 shows the classification of the outstanding credit by the sample companies into short term loans (STLs) and long term loans (LTLs). For better presentation, only two time periods (FY13 and FY18) have been studied.

Figure 6: Classification of the loans granted by NBFCs into short term and long term (%)



Source: CARE Ratings

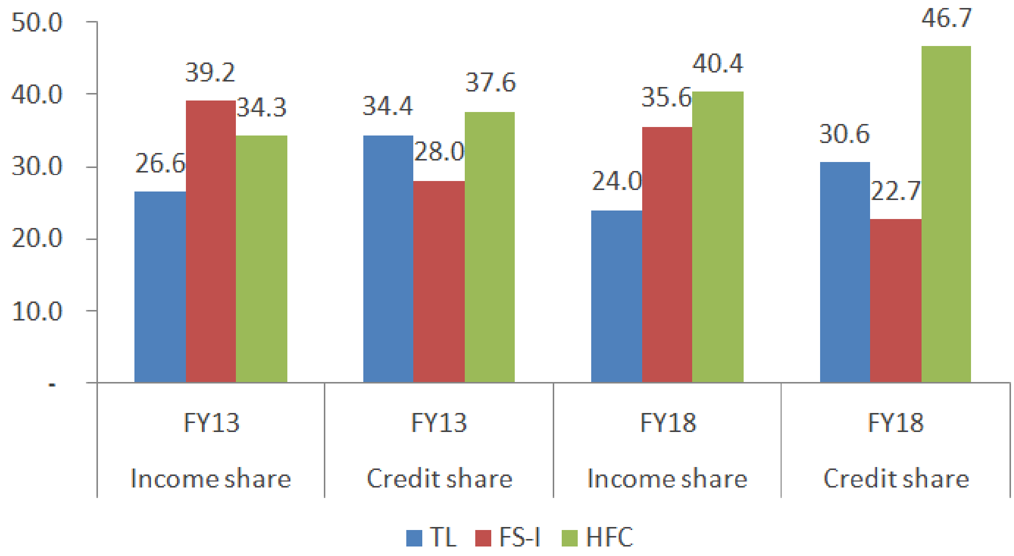
Though the short term lending undertaken as a proportion of total lending has reduced in case of HFCs, it has been observed that the share of short term lending has increased in case of FS-I and Term lending institutions. In case of HFCs, despite the fall in share of short term credit disbursed, the total short term lending has doubled and rose at a CAGR of 16% during FY13 to FY18. In case of term lending institutions, the total short term lending has doubled and witnessed a significant CAGR of 15.5% during FY13 to FY18.

The RBI study highlights the exposure of NBFCs credit to key sectors during FY12 to FY17. Data shows that the credit towards industry has declined after scaling a peak of 62.8% of the total credit in FY15 to 59.6% in FY17. There has been a higher exposure towards the services and retail segments. The retail segment which includes housing loans, vehicle loans and education loans has witnessed a significant rise from 3.4% in FY15 to 17.7% in FY17. The share of services' sector has increased from 11.5% in FY15 to 14.7% in FY17. The re-orientation towards services and retail segments is an indication of increasing credit disbursed for short term and medium term projects. However, the majority share of credit (59.6%) continues to be extended to the industry sector for long term turnkey projects.

Profitability indicators

Figure.7 Summaries the total income during the last 5 years and the growth in the income during this period. It is observed that, barring FY16, the total income of the sample companies under study has witnessed rapid and double digit growth in income. The total income of these companies has grown at CAGR of 12.2% during FY13 to FY18.

Figure 7 : Total income (Rs. lakh crs) and income growth (%)



Source: CARE Ratings

Figure 8 exhibits the share of income of each of the three categories of NBFCs and juxtaposes with the share of credit (outstanding loans and advances) for FY13 and FY18. The credit share covered in the following chart is the quantum of the outstanding credit of the NBFCs as at the end of the year. The objective of the following chart is to find out which category of the NBFC sector has the highest share in total income , total credit and how has it changed between FY13 and FY18.

The share of total income for FS-I has declined from 39.2% in FY13 to 35.6% in FY18 while that of TLs has declined from 26.6% in FY13 to 24% in FY18. On the other hand, the income share of HFCs has increased from 34.3% in FY13 to 40.4% in FY18, now contributing the highest income share among the three categories, based on the samples covered.

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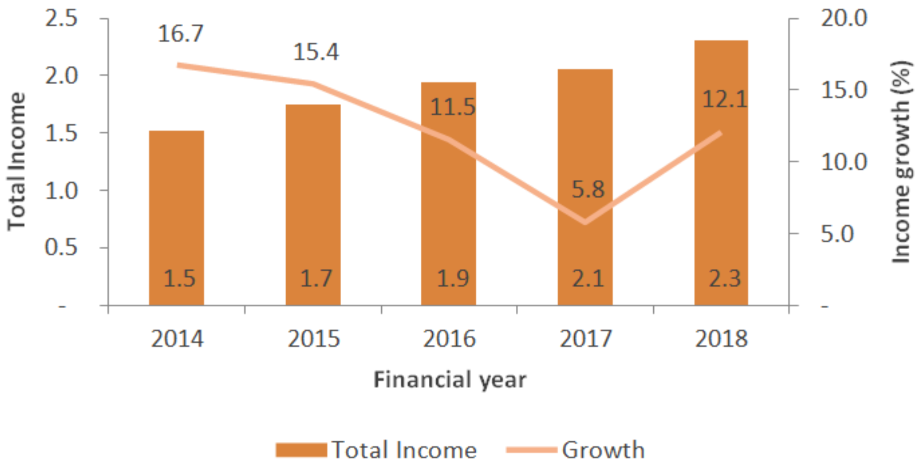
The significant increase in the share of income for HFCs can be ascribed to the rise in the credit share of the HFCs from 37.6% in FY13 to 46.7% in FY18. The HFCs also has the highest share in outstanding credit in FY13 and FY18.

Figure 8: Share of individual categories in total income (%) and total credit (%) in FY13 and FY18

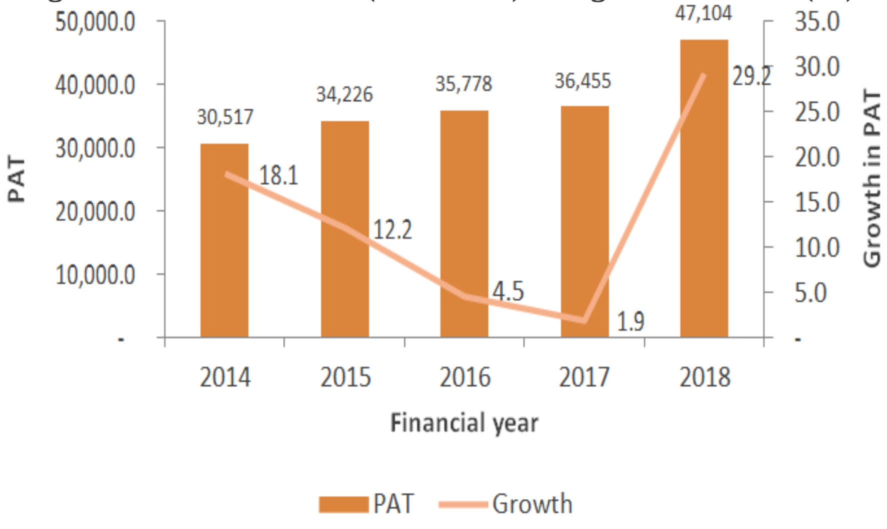


Source: CARE Ratings

Note: Figures within the bar represent total income

Figure 9 analyses the profit after tax (PAT) and its growth during FY14 to FY18. There was a significant decline in growth of PAT from FY14 to FY18 from 18.1% in FY14 to 1.9% in FY17. The PAT has been upbeat and grown by 29.2% in FY18. The moderation in profit growth in FY17 can be attributed to increased provisioning norms for the NBFC sector as well as increased public funding raised by the sector companies. The provisions in case of TLs witnessed a sharp increase of 156% in FY17 over a growth of 109% in FY16. Similarly, the FS/I also witnessed a growth in provisions of 38% in FY17 over a growth of 43% in FY16. The growth in provisions in case of HFCs during FY17 was relatively lower compared to the other categories and stood at 12% in FY17 over a growth of 201% in FY16. Demonetization is also another factor which led to moderation in credit disbursements to various sectors during FY17 which in turn had an adverse impact on income and profits. The significant jump in credit of 19.6%% and moderation in provisioning in FY18 has led to a growth in PAT in FY18.

Figure.9: Profit after tax (PAT – crs) and growth in PAT (%)

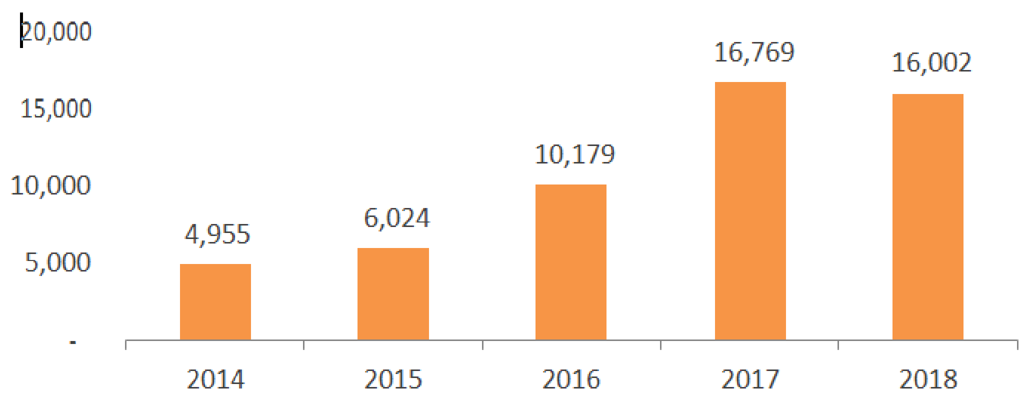


Source: CARE Ratings

The share of housing finance segment has increased from 33.7% in FY14 to 46.7% in FY18, having a scaled a peak of 48.6% in FY17. The share of FS-I segment has remained relatively stable at around 30% during the last 5 years while the share of term lending institutions have witnessed a significant decline from 33.4 % in FY14 to a low of 20.1% in FY18.

The decline in profit after tax during FY14 to FY17 is also reflected in the decline in return of assets (ROA) indicator from 2.4% in FY14 to 2.1% in FY17. The provisions in the overall NBFC sector have more than tripled in the last 5 years having witnessed a CAGR of 26.7% during this period. Chart 13 exhibits the trend of the quantum of the NBFC provisions.

Figure`10: Total provisions of the NBFC sector (Rs. crs)



In FY18, the highest share of provisions of 57% is observed in the FS-I segment followed by term lending institutions (28%) and housing finance companies (15%). This increase in provisioning in overall NBFC sector during FY17 can be juxtaposed with NPA ratio for this sector. The Financial Stability Report released for the June’2018 gives the breakup of the Gross Non- performing asset (GNPA) ratio and Net Non-performing asset ratio (NNPA) ratio from FY13-FY18. This calculation is based on a detailed study by the central bank based on 11,402 NBFCs and is presented in Table 2. The table shows that the asset quality (GNPA ratio) of the NBFC sector worsened in FY17 to 6.1% and has marginally moderated to 5.8% in FY18. However, it is to be noted that the asset quality of the banking sector has declined at a much faster rate from 3.2% in FY13 to 11.6% in FY18.

Recent RBI Regulations for NBFCs

To address the liquidity crunch faced by some segments of the NBFC sector, primarily on account of asset liability mismatches, the RBI has come up with regulatory relaxations to ease the challenges of the sector.

Banks are permitted to raise their exposure to a single NBFC (non infrastructure financing NBFC) from 10% to 15% until the end of the year. Till Dec 31, 2018, the government securities equivalent to the incremental credit disbursed by the banks to NBFCs after October 19 will be eligible for Liquidity Coverage Ratio (LCR) requirements. This is in addition to the 13% carve out from Statutory Liquidity Ratio (SLR) norms permitted for use against LCR requirements. To provide partial credit enhancement (PCE) to bonds issued by systematically important non-deposit taking financial companies (NBFCs) registered with RBI and HFCs registered with National Housing Bank.

CONCLUSION

The overall NBFC sector credit growth has been significantly faster in FY18 than the bank credit growth. Although the growth in the total income of the sample companies in all 3 categories has moderated during FY14-FY17, the income growth has been robust and double-digit barring FY16 which had single digit growth in income. The growth in incomes is at a commensurate pace with the growth in the credit extended by the NBFC sector has a whole. The growth in the net profits of the sample companies at the aggregate level (all categories taken together) has moderated from 18.1% in FY14 to 1.9% in FY17 which can in part be attributed to higher NPA provisioning during this period. In addition, during this period, the return on total assets also declined from 2.4% in FY14 to 2.1% in FY17. The robust credit growth in FY18 and moderation in the NPA provisioning in FY18 has translated into a significant increase in the net profits in FY18. It is to be noted that faster credit growth could be partially covering/lowering the NPA provisioning in FY18 as well.

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