Non-Banking Financial Companies

A financial institution is an institution which collects funds from the public, and places them in financial assets, such as deposits, loans and bonds rather than tangible property.

A non-bank financial institution (NBFI) is a financial institution that does not have a full banking license or is not supervised by a national or international banking regulatory agency. Non-banking financial institutions are financial institutions that provide banking services, but do not hold a banking license. These institutions are not allowed to take deposits from the public. In India, NBFCs are registered under the Companies Act, 1956. The number of non-banking financial companies has expanded considerably after the industrial, retail and venture capital companies entered the lending business.

Some of the NBFCs operating in India are NABARD, PFCL, Infrastructure Development Finance Company Limited, Shree Global, Reliance Capital, Shriram Transport Finance, Muthoot Finance, LIC Housing Finance and RECL.

According to the Reserve Bank of India (Amendment Act) 1997, A Non-Banking Finance Company means:

i. A Financial Institution which is a company;

ii. A non-banking institution which is a company and which has as its principal business the receiving of deposits under any scheme of arrangement or in any other manner or lending in any manner;

iii. Such other non-banking institution or class of such institutions as the bank may with the previous approval of the Central Government specify.

Functions of NBFCs

- Brokers of loanable funds
- Mobilization of savings
- Channelization of funds into investment
- Stabilize the capital market
- Provide liquidity
- Inducement to Save

- Economies of Scale
- Financial Intermediation

Importance of NBFCs

Non banking financial institutions have the following importance in Indian economy:

- Greater reach
- Flexibility in tapping resources
- Retail services to small and medium business
- Important component of financial market
- Development of sectors like Transport & Infrastructure
- Substantial employment generation
- Help & increase wealth creation
- Broad base economic development
- To finance economically weaker sections

Types of NBFCs

The Non-Banking Finance Companies operating in India fall in the following broad categories.

1. **Equipment Leasing Company** is a company which carries on as its principal business, the business of leasing of equipments or the financing of such activity. Apart from their Net Owned Funds (NOF), the leasing companies raise finds in the form of deposits from other companies, banks and the financial institutions.

   There are two types of leases:

   a) **Operating lease:** Short-term lease which can be cancelled

   b) **Financial or capital lease:** A non-concealable contractual commitment.

2. **Hire Purchase Finance Company** is a company which carries on as its principle business, hire purchase transactions or the financing of such transactions. Hire-purchase finance or credit is a system under which term loans for purchase of goods, producer goods or consumer

goods and services are advanced which have to be liquidated under an installment plan. The period of credit is generally one to three years. The hire purchase credits available for a wide range of products and services. Hire-purchase finance companies are the public or private limited companies or partnership firms engaged in giving credit for acquiring durable goods.

3. **Housing Finance Company** is a company which carries on as its principle business, the financing of the acquisition or construction of houses including the acquisition or development of plots of lands for construction of houses. These companies are supervised by National Housing Bank, which refinances housing loans by scheduled commercial banks, co-operative banks, housing finance companies and the apex co-operative housing finance societies.

4. **Investment Company** means any company which carries on as its principle business the acquisition of securities. These types of companies are investment holding companies formed by business houses. As such they provide finance mainly to companies associated with these business houses.

   As compare to open-end investment companies or mutual funds/units trust, these investment companies are close end companies having a fixed amount of share capital. Almost all prominent industrial groups have their own investment companies.

5. **Loan Company** is a company which carries on as its principle business, the providing of finance whether by making loans or advances or otherwise for any activity other than its own. (This category excludes No.1 to No. 3 above categories).

   These types of companies are generally small partnership concerns which obtain funds in the form of deposits from the public and give loans to wholesale and retail traders, small scale industries and self-employed persons. These companies collect fixed deposits from the public by offering higher rates of interest and give loans to others at relatively higher rates of interest.

6. **Mutual Benefit Finance Company** (i.e. Nidhi Company) means any company which is notified by the Central Government under section 620A of the Companies Act, 1956. The main sources of funds for nidhis are share capital, deposits from their members and deposits from the public.

   Nidhis give, loans to their members-for several purposes like marriages, redemption of old debts, construction and etc. The nidhis normally follow the easy procedures and offer saving schemes and make credits available to those whose credit needs remain unmet by his commercial banks.

7. **Chit Fund Company** is a company which collects subscriptions from specified number of subscribers periodically and in turn distributes the same as prizes amongst them. Any other form of chit or kuri is also included in this category. The chit fund companies operations are governed by the Chit Fund Act, 1982, which is administered by State Governments. Their deposit taking activities are regulated by the Reserve Bank.

   The chit fund companies enter into an agreement with the subscribers that everyone of them shall subscribe a certain amount in installments over a definite period and that every one of such subscriber shall in his turn, as determined by lot or by auction or by tender, be entitled to a prize amount.

8. **Residuary Non-Banking Company** is a company which receives deposits under any scheme by way of subscriptions/contributions and does not fall in any of the above categories.

List of NBFCs in India

1) Housing Development Finance Corporation Limited
2) National Bank of Agricultural and Rural Development
3) Infrastructure Development Finance Company Limited
4) Shriram Transport Finance Company Limited
5) Bajaj Finance Limited
6) Mahindra & Mahindra Financial Services Limited
7) Muthoot Finance Ltd
8) Tata Capital Financial Services Ltd., etc.

Difference between NBFC and Banks

BASIS	NBFC	BANK
Meaning	An NBFC is a company that provides banking services to people without holding a bank license.	A bank is a government authorized financial intermediary that aims at providing banking services to the general public.
Incorporated Under	Companies Act, 1956	Banking Regulation Act, 1949

Scope of Business	Limited	Various types of business regarding financial activities
Demand Deposit	Not Accepted	Accepted
Foreign Investment	Allowed up to 100%	Allowed up to 74% for private sector banks
Payment & Settlement system	Not a part of system	An integral part of the system; provides you services like RTGS, NEFT, UPI, debit and credit cards, EFT, etc.
Deposit insurance facility	Not Available	Not Available
Credit Creation	NBFCs do not create credit	Banks create credit
Legal Reserve Ratios	No such requirement	Mandatory to maintain CRR & SLR as per regulations of RBI.