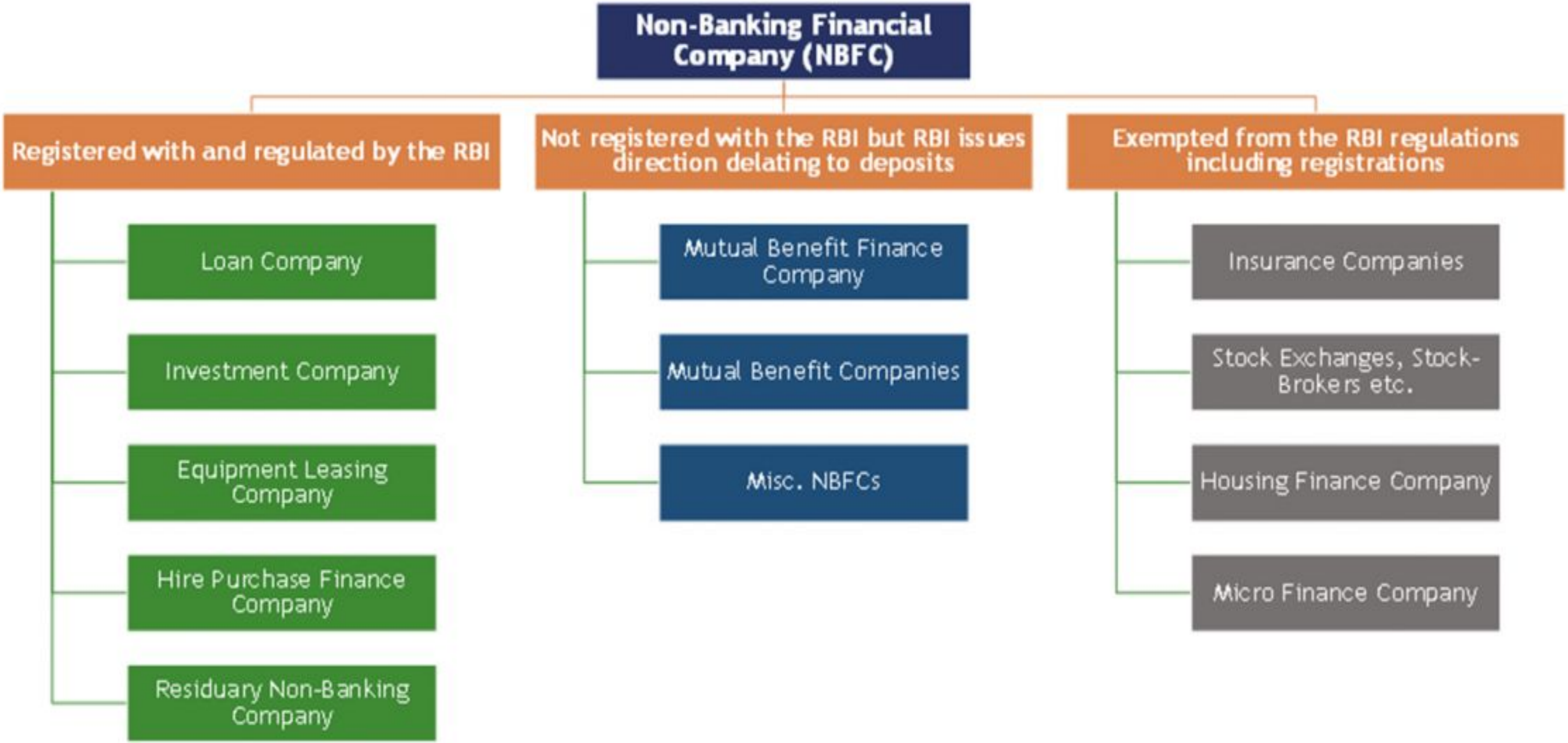
NBFC

Non-Banking Financial Company

A non-banking financial institution is a financial institution that does not have a full banking license or is not supervised by a national or international banking regulatory agency.



Source: RBI; Pradhan Mantri Jan Dhan Yojana; Indian Banks' Association - Indian Banking Sector 2020

Current outlook of the sector

- Most recently, as of Jan 22, 2021, there were 9,425 NBFCs registered with the RBI categorized as Asset Finance Companies, Loan Companies, Infrastructure Finance Companies (IFCs), Systematically Important Core Investment Company (NBFC – CIC – ND – SI), Infrastructure Debt Fund (NBFC – IDF) and Micro Finance Institutions (NBFC – MFIs).
- The asset quality of non-banking finance companies will see elevated stress levels in the near term due to the second wave of the pandemic, but the stress will subside subsequently as collection efficiencies improve and restructuring picks up, says rating agency Icra. The spike in stress in the asset quality of the shadow banks stems from a combination of factors.
- Reflecting a gradual pick-up in activity, finance companies reported a strong 37.6 per cent growth in sanctions in categories like vehicle loans, housing loans and loan against shares (LAS), among others, at Rs 1.24 trillion in Q1 (first quarter) of FY22 compared to Rs 90,615 crore in Q1 of FY21.
- The scale of sanctions was still way below the Q1 numbers of FY20, which stood at Rs 2.38 trillion, according to data by the Finance Industry Development Council (FIDC).
- Contrary to the growth in NBFC segment, banking system credit was aneamic, rising at mid-single digit at the end of Q1. Only in Q2, the credit growth has picked up pace somewhat, but still in single digits.
- Banking system credit grew just 6.7 per cent year-on-year on August 27, which is better than last year’s 5.5 per cent growth, but still far lower than how the retail-focused NBFCs are expanding their credit books.

Growth Potential of the sector

- Non-banking Financial Companies (NBFC) sector in India has undergone a significant transformation over the past few years and plays a significant role in the growth of the Indian financial system.
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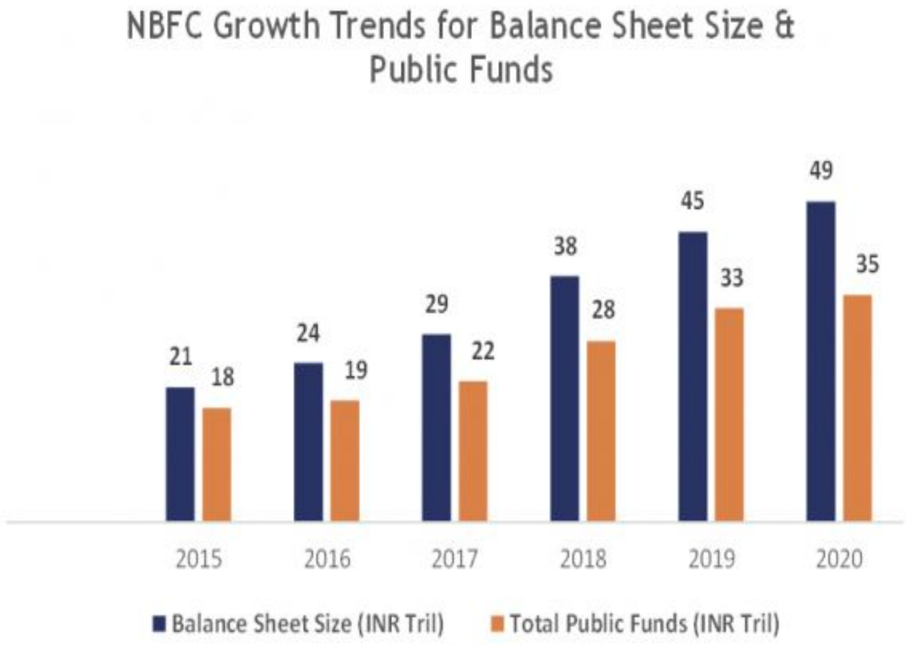
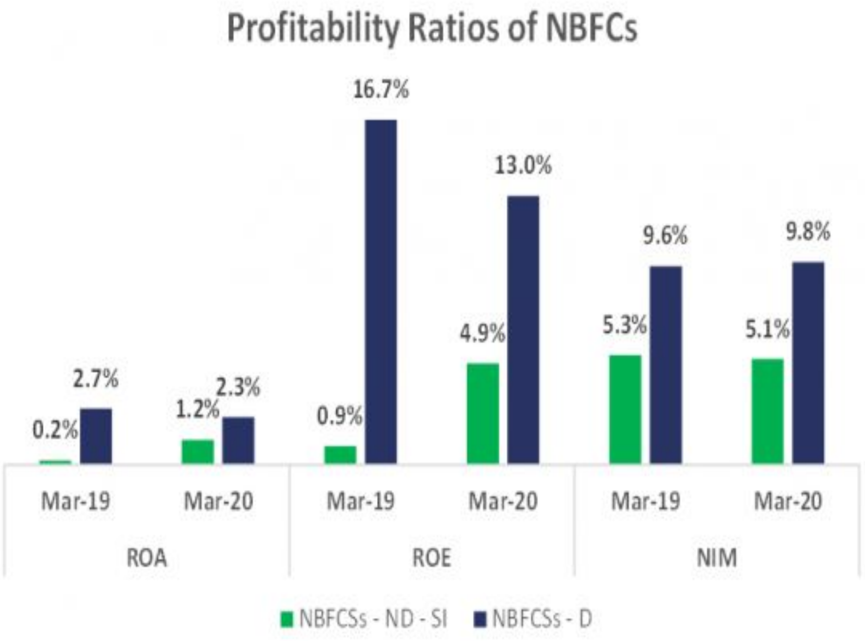
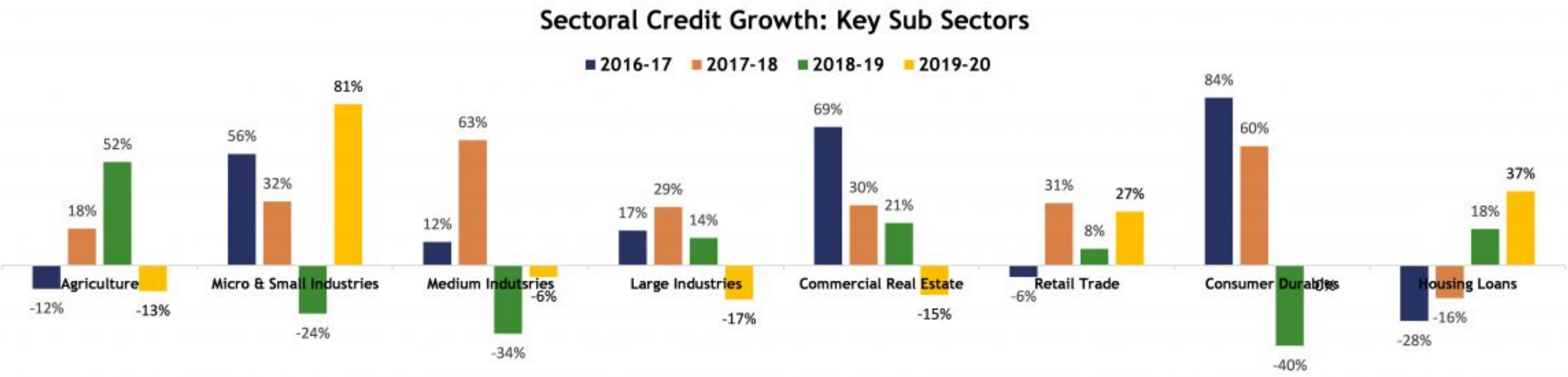
- Non Banking Financial Companies have outperformed banks in the Mortgage Industry, by leveraging technology in credit deployment. Technology has made NBFC's expand into underserved segments, where the banks don't serve.
- The total Credit market of NBFC's is going up from 13% FY16 to 16% FY17 to 20% FY18. The average growth of NBFC's will be 4-6% every FY.
- Newly formed NBFCs are using advanced technology which will result in a better future of NBFCs. Technologies like Artificial Intelligence, Machine learning have prepared the lenders in evaluating the customer's perception and also in maintaining alternative credit scoring models.
- Some of the key sectoral credit growth across key sub-sectors is for MFIs which have clocked 80% growth in 2019-20 and housing loans which have registered 37% growth in the same timeframe. Similarly, growth in loans and advances for NBFC-IDFs and NBFC-MFIs have registered strong growth at 46% and 8% respectively for 2019-20 period and similarly also demonstrated an upward growth trend in 2018-19.
- According to the statistics by the Futures Industry Association (FIA), a derivatives trade association, the National Stock Exchange of India Ltd. (NSE) emerged as the world's largest derivatives exchange in 2020 in terms number of contracts traded. NSE was ranked 4th worldwide in cash equities by number of trades as per the statistics maintained by the World Federation of Exchanges (WFE) for CY2020.
- India is expected to be the fourth largest private wealth market globally by 2028.





Source: RBI; Pradhan Mantri Jan Dhan Yojana; Indian Banks' Association - Indian Banking Sector 2020



Sectoral Credit Growth: Key Sub Sectors
2016-17
2017-18
2018-19
2019-20
Agriculture
Micro & Small Industries
Medium Indutsries
Large Industries
Commercial Real Estate
Retail Trade
Consumer Durables
Housing Loans
-12%
18%
52%
-13%
56%
32%
-24%
81%
12%
63%
-34%
-6%
17%
29%
14%
-17%
69%
30%
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31%
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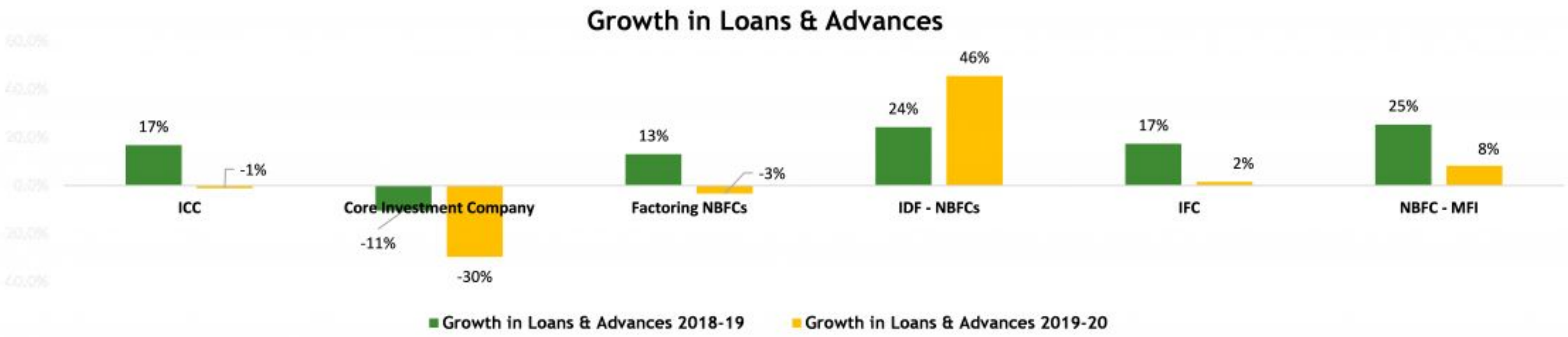
-28%
-16%
18%
37%



Growth in Loans & Advances
ICC
Core Investment Company
Factoring NBFCs
IDF - NBFCs
IFC
NBFC - MFI
17%
-1%
-11%
-30%
13%
-3%
24%
46%
17%
2%
25%
8%
Growth in Loans & Advances 2018-19
Growth in Loans & Advances 2019-20

Competition in the sector

There are many firm under this sector and competing with each other but these firms also have to compete with banks as well

- Both NBFCs and banks provide personal loans. While banks are recognised for their lower interest rates, NBFCs are improving rapidly by giving individuals competitive rates. If you need money quickly and without any difficulty, NBFCs are a good solution.
- On the other hand, Banks are reliable and offer more competitive rates to NBFCs. Banks Depositors can avail the deposit insurance service of banks. So, if you want to play safe, you may choose banks.
- As compared to banks, NBFCs follow more flexible approach to avail a business loan. They make it easy for the customers to avail fast and quick financing. Inspite of having a low credit score one can effortlessly avail for a business loan from a leading NBFC.
- The major firms are Muthoot Finance Limited, Reliance Capital Limited, Power Finance Corporation Limited, Bajaj Finance Limited etc.

Reasons for Competitions:

1. Existence of Banks
2. High Entry And Exit Barriers
3. Lack of belief by some consumers

GOVT POLICIES

- On September 30, 2021, the Reserve Bank of India communicated that the applicable average base rate to be charged by non-banking financial company - micro finance institutions (NBFC-MFIs) to their borrowers for the quarter beginning October 1, 2021, will be 7.95%.
- In July 2021, Rajya Sabha approved the Factoring Regulation (Amendment) Bill in 2020, enabling ~9,000 NBFCs to participate in the factoring market. The bill also gives the central bank the authority to establish guidelines for improved oversight of the US$ 6 billion factoring sector.
- The government has approved 100% FDI for insurance intermediaries and increased FDI limit in the insurance sector to 74% from 49% under the Union Budget 2021-22.
- Source - https://www.ibef.org/industry/financial-services-india.aspx

MARCOECONOMICS EFFECT

NBFCs are considered “cyclical firms” whose fortunes are tied to the macroeconomic conditions.

Among NBFC specific factors, income ratio (total income over total assets) and funding cost (interest expenses over total borrowings) were found to play a significant role in determining profitability of NBFCs. Credit risk (loan loss provisions to total credit) and efficiency (ratio of operating cost to total income) were found to have negative effects, as expected- additional provisioning reduces funds availability for on-lending and investment and increased salaries and administrative costs reduce profits. NBFC business (credit plus investment) positively impacted profitability (Table

1). Capital assets ratio and liquidity (cash and bank balances to total assets) were not found to be significant.

Among industry specific factors, the effective tax rate-defined as taxes paid divided by before-tax profits-adversely impacted profits as expected. In the case of macroeconomic control variables, nominal GDP growth taken with a lag to control for reverse causality positively impacted RoE, signifying pro-cyclicality of NBFCs' profitability. The Herfindahl-Hirschman Index (HHI), taken as proxy for market concentration and defined as the sum of squares of market share of each NBFC in a quarter was not found to be significant in affecting NBFCs' profitability.

To sum up, firm-specific factors like income ratio, funding cost, credit risk and efficiency play an important role in determining NBFCs' profitability. Among industry and macro variables, effective tax rate and GDP growth were also key determinants of profitability. - https://rbi.org.in/scripts/PublicationsView.aspx?id=20272

- The consolidated balance sheet of NBFCs grew at a slower pace in Q2 and Q3:2020-21. However, NBFCs were able to continue credit intermediation(matching), although at a lower rate, reflecting the resilience of the sector.
- The Reserve Bank and the Government undertook various liquidity augmenting measures to tackle COVID-19 disruptions, which facilitated favourable market conditions as indicated by the pick-up in debenture issuances.

(note - A debenture is a type of bond or other debt instrument that is unsecured by collateral. Since debentures have no collateral backing, they must rely on the creditworthiness and reputation of the issuer for support. Both corporations and governments frequently issue debentures to raise capital or funds.)

- Among sectors NBFCs lend to, industrial sector, particularly micro and small and large industries, were the hardest hit by the pandemic as they posted decline in credit growth (demand of loans).
- Profitability of the sector improved marginally in Q2 and Q3:2020-21 as NBFCs' expenditures registered a steeper fall than income. The asset quality of NBFCs improved in Q2 and Q3:2020-21, vis-à-vis Q4:2019-20, on account of regulatory forbearance to mitigate the impact of COVID-19. -

regulatory forbearance - A regulatory policy (i.e., a policy implemented by central banks and other regulatory authorities) that permits banks and financial institutions to continue operating even when their capital is fully depleted.

Source - https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=51588

PESTEL / PEST / STEP Analysis of NBFC(India)

PESTEL Analysis is a strategic management tool that many NBFCs can use to make better decisions.

PESTEL stands for – Political, Social, Economic, Technological, Environmental and Legal factors that impact the macro environment of the company that it operates in.

Political Factors in PESTEL Analysis

Political factors are often related to the level of intervention and nature of intervention of the local and national government in the business and economic environment. Government policies and governance system plays a huge role in nature and objectives of the policies.

Taxation policies – Over the last few years NBFCs have benefitted from lower taxation policies throughout the western hemisphere. It has resulted in high profits and increasing spending in the research and development. The increasing inequality in India can lead to changes in the taxation policies. Secondly local governments are also looking into Insurance (Life) specific taxation policies to contain the carbon footprint of the financial sector.

Other stakeholders such as non-government organizations, protest & pressure groups, activist movements play critical role in policy making in India. NBFCs should closely collaborate with these organizations so that it can contribute better to the community goals as well as with corporate goals.

Political stability in the existing markets – most NBFCs operate in numerous countries so they have to make policies each country based on the Insurance (Life) industry specific requirements. Given the recent rise in populism across the world the common belief is that India can see similar trends and may lead to greater instability in the India market.

Government of India has come under increasing global pressures to adhere to World Trade Organization's regulations on Insurance (Life) industry.

Regulatory Practices – NBFCs have to manage diverse regulations in the various markets it is present in. Over the last few years India and other emerging economies have changed regulations regarding not only market entry but also how companies in Insurance (Life) can operate in the local market.

Economic Factors in PESTEL Analysis

Economic factors include – inflation rate, the stage of economy of country name, consumer disposable income, interest rate, economic performance of country name, exchange rate, labour market conditions, taxation rate etc.

Efficiency of financial markets in India –NBFCs can access vibrant financial markets and easy availability of liquidity in the equity market of India to expand further globally.

Skill level of workforce in India market – The skill level of human resources in India is moderate to high in the financial sector. Most NBFCs can leverage it to not only improve services in India but also can leverage the skilled workforce to create global opportunities.

Inflation rate – The easy liquidity in the market post the great recession of 2018 will lead to increasing inflation in the India economy.

Increasing liberalization of trade policy of India can help the major NBFCs to invest further into the regions which are so far off-limits to the firm.

Government intervention in the financial sector and in particular Insurance (Life) industry can impact the fortunes of the most NBFCs in India.

Availability of core infrastructure in India – Over the years India government has increased the investment in developing core infrastructure to facilitate and improve business environment. Now NBFCs can access the present infrastructure to drive growth in financial sector in India.

Social Factors in PESTEL Analysis

Each society and culture has its own way of doing business. These social factors can not only help companies like company name to better understand the way of doing business but also in understanding the customer preferences in Financial sector of country name. Social factors include – culture, demographics, health & safety attitudes, societal roles and norms, gender roles, traditions, acceptance of entrepreneurial spirit, attitude towards certain products and services, and leisure interests.

Leisure interests – the customers in the India are giving higher preferences to experiential products rather than traditional value proposition in Financial sector. The Financial companies can leverage this trend to build products that provide enhanced customer experience.

Gender roles – The gender roles are evolving in India. NBFCs should test various concepts to cater to and support these evolving gender roles in India society.

Societal norms and hierarchy – the society of India is different from the home market of most NBFCs. It should strive to build a local team that understands the societal norms and attitudes better to serve the customers in India.

Demographics – For the Financial products, major NBFCs have demographics on its side. India is a young country and growing. The companies under this sector can use this trend to cater to various segments of the population.

Power structure – There is an increasing trend of income inequality in India. This has altered the power structure that has been persistent in the society for over last 6-7 decades.

Technological Factors that Impact NBFCs

Technology is fast disrupting various industries and Financial is no different. There are numerous ways technological factors are impacting the NBFCs in India. Some of the technological factors are – innovation in customer services, supply chain disruption because of technology, population access to technology, access to greater information, rate of technology driven change, innovation in product offerings, access to mobile phones driving empowerment etc.

Developments and dissemination of mobile technology has transformed customer expectations in the Financial sector. NBFCs in India have to not only meet and manage these expectations but also have to innovate to stay ahead of the competition.

Technological innovation is fast disrupting the supply chain as it is providing greater access to information to not only supply chain partners but also to wider players in the Financial industry.

Intellectual property rights and patents protection – If India have higher safeguards for IPR and other intellectual property rights then more and more players are likely to invest into research and development.

Lowering cost of production – The latest technology is fast lowering production and servicing cost in the Financial sector. NBFCs in India have to restructure their supply chain to bring in more flexibility to meet both customer needs and cost structures.

Research and development investment at both macro level and micro level in India. If there is an environment of creative disruption and both government and private players are spending resources on developing new solutions.

Environmental Factors that Impact NBFCs

Environmental norms are also altering the priorities of product innovation. In many cases products are designed based on environmental standards and expectations rather than catering to traditional value propositions.

Customer activism – Greater awareness among customers have also put environmental factors at the centre of many such financial company's strategies. Customers expect them to adhere to not only legal standards but also to exceed them to become responsible stakeholder in the community.

Waste management especially for units close to the urban cities has taken increasing importance for big players in this sector . India government has come up with strict norms for waste management in the urban areas.

Renewable technology is also another interesting area for many companies. They can leverage the trends in this sector. India is providing subsidies to invest in the renewable sector.

Regular scrutiny by environmental agencies is also adding to the cost of operations of many companies.

Legal Factors that Impact NBFCs

Employment law in the India and how they are impacting the business model of the Insurance (Life). Can these conditions be replicated or bettered in international market?

Data protection laws – Over the last decade data protection has emerged as critical part of not only privacy issues but also intellectual property rights. Major players in this sector have to consider whether India have a robust mechanism to protect against data breaches or not.

Health and safety norms in the India and what these companies need to do to meet those norms and what will be the cost of meeting those norms.

Legal protection of intellectual property, patents, copyrights, and other IPR rights in India. How NBFCS will be impacted if there are not enough protection.

Environment Laws and guides – The level of environmental laws in the India and what the companies need to do to meet those laws and regulations.

Business Laws – The business laws procedure that India follows. Are these norms consistent with international institutions such as World Trading Organization, European Union etc.

PORTER’S FIVE FORCE ANALYSIS

Threat of New Entrants (Medium)
Bargaining Power of Customers (Medium)
Competitive Rivalry (High)
Substitute Products (Low)
Bargaining Power of Suppliers (Low)

Competitive Rivalry

- Competitive rivalry between big players is intense in the industry
- Financial services companies often compete on the basis of offering lower financing rates, higher deposit rates and investment services

Threat of New Entrants

- Stringent regulatory norms prevent new entrants
- Customers prefer to invest their money with a reputed financial services company offering a wide range of services

Substitute Products

- Low threat of substitutes
- Less number of substitutes available for financial products

Bargaining Power of Suppliers

- Low bargaining power of suppliers as the industry is highly regulated by RBI

Bargaining Power of Customers

- Medium bargaining power of customers. Although customers do not have much bargaining power, they can easily switch to another company based on the terms and quality of services provided