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CODEN: IJRSFP (USA)

International Journal of Recent Scientific Research
Vol. 8, Issue, 8, pp. 19127-19144, August, 2017

ISSN: 0976-3031

International Journal of Recent Scientific Research

DOI: 10.24327/IJRSR

Research Article

AN OVERVIEW OF NON BANKING FINANCIAL COMPANIES IN INDIA

Deepak Kumar and P. Srinivasa Suresh

Department of Economics, North Eastern Hill University, Shillong-793002 Meghalaya

DOI: http://dx.doi.org/10.24327/ijrsr.2017.0808.0635

ARTICLE INFO

Article History:

Received 05th May, 2017
Received in revised form 08th June, 2017
Accepted 10th July, 2017
Published online 28st August, 2017

Key Words:

Non Banking Financial Companies, Financial Performance, efficiency, economy.

ABSTRACT

The aim of the article is to give an overview of Non Banking Financial Companies in India. The article has examined the total number, type, asset size, type of business, geographical distribution and regulations related to Non Banking Financial Companies. The article also examines the problem and prospect of NBFCs in India.

INTRODUCTION

As per Reserve Bank of India (RBI) Act, 1934, Non-Banking Financial Companies (NBFC) is registered under company act and offer most of the banking services, such as loans and credit facilities, acquisition of shares/stocks/bonds/debentures/ securities issued by government or local bodies, private education funding, retirement planning, marketable securities like leasing, hire-purchase, trading in money markets, and Chit fund activities. They play a vital role in the Indian financial structure and system. Small companies and borrowers lend money from these NBFC's at the local level. These financial companies act as an alternate to the banking systems and increase the level of competition and diversity in the financial sector. Research insists that the banking sector has always been highly regulated however simplified in the terms of sanction procedures, flexibility and timeliness for the purpose of meeting the credit needs and low cost operations. This has occurred as a result of the NBFCs getting an edge over banks in providing funding (Arunkumar, 2014).

The role of NBFC is appreciable at all times, wherein India too is well known for banking operations which are also predominant. The clients who as per the bank norms are rejected for availing loans or other services approach these NBFC's for the same services that are willingly offered to them. In light of this, the growth of NBFC's in the last few years has been exceptional and the overall size of NBFC's assets has increased to about 14% of that of the commercial banks excluding RRB's. The main criteria of NBFC are that they do not involve any organization whose main business is of agricultural/industrial/purchase or sale of any goods (excluding securities)/construction of properties that are immovable. Residuary Non-Banking Company (RNBC) is also another form of NBFC which is involved in attaining deposits under a particular scheme/lump sum/instalments by contributing to the borrowers in their own way. Reserve bank of India act 1934 (section 45-1A) emphasizes all NBFC's to attain registration certificate before commencing their business. In some cases like venture capital fund/Merchant banking/stock broking organizations registered with SEBI or an insurance company with IRDA registration certificate are excluded from this above specified rule of RBI (Volume 01, No.8, August 2015, Page 2). According to RBI, NBFC's can be classified as following:

AFC - Asset Finance Company
IC-Investment Company
LC-Loan Company
IFC-Infrastructure Finance Company
CIC-ND-SI-Core Investment Company (Systematically Important)
IFD-Infrastructure Debt Fund
NBFC-MFI-NBFC-Micro Finance Institution
NBFC-Factors-Non-Banking Financial Company-Factors

Corresponding author:* **Deepak Kumar
Department of Economics, North Eastern Hill University, Shillong-793002 Meghalaya

Micro, Small and Medium Enterprises (MSME) play a lead role in attaining financial support from the NBFC's. Apart from MSME, they also provide support to the public by providing small loans, two wheeler/four wheeler/truck loans, finance for farm equipment, and unsecured working capital financing. If these services are needed by the public from NBFC, they have to undergo only easy and uncomplicated process for sanction of loans and disbursement of credit. Flexibility in repayment of loans, on time is considered to be the main features that attract the customers towards NBFC. Even though NBFC's lend and make investments there are certain differences with respect to the banking sector as given below:

1. NBFC's cannot accept demand deposits
2. NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself
3. Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike that in the case of banks.

Across the world, much research has been done to review the functions and policies of NBFC are helpful in increasing the power and fame among people.

Financial System of India

Overview

In the current decade an extensive development has been made in India with respect to the growth rates with an average in excess of 8 per cent for the last four years and also the stock market growth is over three-fold with a rising inflow of foreign investments. In India during the year 2006, total equity issuance entered \$19.2bn which is considered to be up to 22%. Merger and acquisition volume increased to 38% (\$27.8bn) driven by 371 per cent increase in outbound acquisitions exceeding inbound deal volumes for the first time. Likewise, debt issuance reached up to 28% (\$13.7bn) from a year earlier. Bank of New York survey says that the Indian companies were also actively participating in the service of NBFC by issuing depositary receipts in the early half of 2006 (Ratti, 2012). The main challenge that India faced in first few decades of new millennium are entirely different from those it is experiencing with for decades after independence. Foreign exchange markets underwent liberalization and globalization which gave a new life and also new challenges to them. Commodity trading emerged from scratch to gain attention and scale among public. At this time, banking domain has moved from an era of rigorous control and government intrusion to a more market-governed system. As a result, many foreign banks emerged in India along with many private banks which made their presence felt in a strong manner. Microfinance has started emerging over these years and was considered as an important factor in Indian financial structure. This increased its outreach by providing required financial services to millions of poor Indian household people (Kihara, 1962).

Brief History of Indian Economy

India as the second highest populated country (1.11billion) and fourth largest economy in Public Private Partnership (PPP) terms is closely at the heels of the third largest economy, Japan. After attaining independence in 1947, India was one of the world's poorest country (the manufacturing sector accounted for only one 2 tenth of the national product) but also considered as best formal financial markets in the developing world, with four famous functioning stock exchanges. The Tokyo Stock Exchange (oldest), which gave a clear defined rules of government, trading and settlements, a well enhanced equity culture, a banking structure with clear lending norms and procedures for recovery following the better corporate laws (Jayanthi, 2010).

During this time, many corporate laws and laws protecting the rights of investors were built along with Indian companies' act 1956. Socialism played a main role after independence which gave an outcome of licensing, protection and in turn a wide spread of corruption. In 1990-1991, India suffered from severe payment crisis which guided in an era of reforms comprising of deregulation, partial privatization of state sector enterprises and liberalization of external sectors. India grew at an average of 3.5% ("The Hindu rate of growth") and then increased to 5.6% since 1980's after independence. In the middle of 1970's the growth began and the annual GDP growth rate of 5.9% (based on inflation adjusted, constant prices) prevailed during 1990 to 2005. This growth rate is considered to be the second largest among the world economies behind china's 10.1%. India's GDP was generated in the service sector during 2004 and 52% was the outcome from it. While, the manufacturing (agriculture) sector produced only 26% (22%) of GDP. With respect to employment, agriculture was accountable for about two-thirds of half of billion labour force which indicated the poor production and unemployment. Majority (90%) of labour force worked in the unorganized sector (Jayanthi, 2010).

Indian Economy and Financial Markets since liberalization

In the early 1990's India faced a major switch over in economic terms due to the emerging of economic reforms. According to the terms of globalization unorganized sector comprises of: 1) All the enterprises except companies registered under Section 2m(i) and 2m(ii) of the Factories Act, 1948, Cigar Workers (condition of employment) Act, 1966; and 2) all enterprises except those run by the central/state government and local bodies or Public Sector Enterprises. 3 The deregulation has breathed a new life to private business and the long-protected industries in India are now facing the challenge of foreign competition as well as the opportunities of world markets. In 1980, the GDP has doubled in constant prices due to the continuous increase in growth rate. The conclusion of 'License Raj' has removed major obstacles from the way of new investments (Sinha *et al*., 2015). The unambiguous ascent in the ration following the concept of liberalization leads to greater heights in economy. The average rate of inflation with respect to price stability has been closer to the preceding half decade except in the last few years when inflation has decreased to significantly lower levels. There was a major structural change in India's macro economy due to the decline in the interest rates (Saha, 2012).

Globalization, deregulation in the outside world and the external sector played a vital role in transforming Indian economy in the past twelve years. The quick and easy measure of the rise in India's integration with the world economy is a standard way of 'openness'- the need of foreign trade in national income. Imports increased at a consistent level which in turn improved the exports and vice versa. 'Export pessimism' marked India's foreign trade policy as a powerful factor. Trade deficits have been continued after liberalization. Foreign investments in India flowed as well as FDI (and more recently in the form of External Commercial Borrowing (ECBs) by Indian firms) have been substantial and consistent. Over the years, both these flows improved the growth rates in decent and average levels. FDI flow is less elusive compared to portfolio flows. Increase in the concern of 'hot money' prevailed into the country due to portfolio flows. A recent study by Morgan Stanley holds "bureaucracy, poor infrastructure, rigid labour laws and an unfavourable tax structure" in India as responsible for this poor relative performance. This difference should be viewed more as indicative with respect to the future growth in the opportunities of FDI flows provided India follows its second generation reforms and should not be cryptic in India's significant achievement of attracting foreign investments since liberalization. As a result of substantial capital inflows, the foreign exchange reserves situation for India has improved beyond the greatest imagination of any pre-liberalization policymaker. Currently, the RBI has a foreign exchange reserve crossing two hundred billion US dollars, which was impossible at the start of liberalization. Figure 1 clearly depicts the evolution of India's foreign exchange reserve position since liberalization. Indian rupee also attained more stability against the major world currencies. The increase in the control on rupee in terms of liberalization, considerable amount of value also increased. The value of the floating rupee stabilized itself during the late 1990's and has appreciated against the currency US dollar within few months. In other words, the rupee is currently undervalued against the dollar as it is managed by RBI (Temperton, 2015).

Morgan Stanley in 2004 says that, 'A lot has changed in the world beyond India's borders during these years'. The second largest economy Japan faced a long recession over a period. In 1997, the Asian Crisis smashed South-East Asia and Korea. Europe has entered into a union creating the Euro that now rivals the US dollar in importance with respect to world currencies. Likewise Russia, Argentina and turkey also witnessed huge financial crisis. The birth of internet made stock markets in US and other countries to huge heights before crashing back down. India has appeared largely unmarked from the Asian crisis. Many people attribute this insulation to the control of capitals that prevailed continuously in India. Indian financial markets became attuned to international markets. It gave birth to the financial integration of India with other parts of the world. The history of India's stock exchanges (4 at independence to 23 today) and around 10,000 listed firms, the size and the role in terms of allocating resources of the market are dominated by the banking domain similar to other countries. In the early 1980's, equity markets were not important as a funding source. India's market capitalization to GDP ratio raised about 3.5% in the early 1980's and to 59% increase in 2005. This gave a ranking of 40 among 106 countries. We can infer that the total bank deposits ($527 billion dollars) are equal to 52% of GDP in 2005, and comprises of three-quarters of the country's total financial assets. In a series of research papers in the late 1990s, La Porta, Lopez de Silanes, Shleifer and Vishny (LLSV) have empirically demonstrated the effects that the investor protection embedded in the legal system of a country has on the development and nature of financial systems in the country. They also insist that 6 common-law countries provide better investor protection than civil law countries leading to "better" financial and systemic outcomes for the former including a greater fraction of external finance, better developed financial markets and more dispersed shareholding in these countries as compared to the civil law countries. The LLSV averages of financial system across different legal system serves as a path through which an individual country's financial system can be compared. Table 1 gives a comparison of India's financial system (2003 figures) with those of LLSV sample countries (La Porta *et al*., 1997, 1998), using measures from Levine (2002). With respect to size, India's banking domain is much smaller than the other LLSV sample countries, even though its efficiency (overhead cost as fraction of total banking assets) compares favourably to most countries.

India's stock market size (total market capitalization with fraction of GDP) is larger than the banking sector, but it is below LLSV average. But, in terms of floating supply of the market, the Indian stock market is only half of the banking sector. The two factors 'structure activity and structure size' measures whether the financial system is powered by bank or stock market. India's activity size figure is below even with the average of English origin countries as India has a market dominant system. In terms of Structure efficiency of the market vs. banks, India's banks are much more efficient than the market and this dominance is stronger than for the average level of LLSV countries (Temperton, 2015).

India's development of financial system with respect to banks and markets, the size is much smaller than the LLSV- sample average level. Finally, based on the above fact we can conclude that the India's stock market and banking domain are small relative to the other countries. An estimation of 45% of the total market capitalization of listed firms is actively traded in India, and hence a value traded in terms of GDP ratio of 0.16 is calculated. The float supply figure of 45% is based on our own calculation of free float adjustment factor of about 1,000 large firms listed on the Bombay stock exchange(small firms are less frequently traded than large firms). The size of its economy, and the financial system is dominated by an efficient (low overhead cost) but significantly under-utilized (in terms of lending to non-state sectors) banking sector (Sinha *et al*., 2015).

Moreover, the situation has changed in recent years: Since the middle of 2003 through to the third quarter of 2007, Indian stock prices have appreciated rapidly. Figure 1 shows the rise of Indian equity market which made the investors to earn higher returns by investing in Bombay Stock Exchange (BSE) or BSE's SENSEX Index than from investing in the S&P 500 Index and other indices in the U.K., and Japan during the period. Only China was better in this area. The two major Indian exchanges Bombay stock Exchange (BSE) and National Stock Exchange (NSE) has been compared with other major exchanges in the world. During the last half of 2005, BSE was the sixteenth largest stock market in the world in terms of market capitalization. NSE ranked as eighteenth in the world. Trading in BSE is one of the most concentrated among the largest exchanges in the world, with the top 5% of companies (in terms of market capitalization) accounting for over 72% of all trades, but the (share) turnover velocity of BSE (35.4% for the year) is much lower than that of exchanges with similar concentration ratios. Indian markets outperformed most major global markets handsomely during 1992-2006. In 2004-05, non-governmental Indian companies raised $2.7 billion from the market through the issuance of common stocks, and $378 million by selling bonds/debentures (no preferred shares).

The financial markets in India are comparatively smaller than the size of its population and economy, irrespective of the size of new issues4. It has been evidenced through the Reserve Bank of India's Handbook of Indian Statistics that there has been a rapid growth in portfolio investments as well as foreign direct investment (in stocks and bonds) in the past 15 years. In fact, it also reports that the size of bonds have reached twice the size of stocks. In 2005, the cumulative foreign investment flow equalled 11.58% of the GDP whereas, it was just 0.03% in 1990. Findings by Morck *et al*. (2000) reveal that as compared to developed nations, prices of stock are more synchronous in emerging economies. According to the authors, this occurrence is attributed to imperfect market regulation and poor protection for minority investors within emerging markets. Whereas, the frequency of stock movement is much less in India as compared to that in China (which incidentally is said to be the worst the world over), at the same time, they happen to be more synchronized as compared to those in markets that are already developed such as the U.S.8 in several other nations. An external market comparison of stocks and bonds in various country groups (by legal origins) and in India is presented through Table 1 through the use of measures from LLSV (La Porta *et al*., 1997).

The graph presents a large number of nations that have an English common-law origin (French civil-law origin) on the top-right region (bottom-left region). Within the graph, India has been aptly positioned in the south-eastern region and has a comparatively strong legal protection (specifically, protection that is extended by the law) however with financial markets that are smaller. The financial sector, in tandem with the rest of the economy or even slightly greater than the rest, the financial markets in India has experienced an important transformation from the time of market liberalization. Though it has not been that easy going however, the outcomes have been more or less positive. The banking sector in India has witnessed a steady growth in size (from the aspect of total deposits) over the decades, where the average annual growth rate was recorded at 18%. Out of the total 100 commercial banks that are functional today, 30 of them are owned by state, 30 happen to be private sector banks while the remaining 40 are foreign banks. The market nonetheless is dominated by banks that are owned by the state (accounting for around 80% of assets and deposits). The post liberalization era has witnessed the rise of new private sector banks and has also seen many new foreign banks entering the market (Sinha *et al*., 2015).

As a result the concentration ratio in India is quite low as compared to other emerging markets (Demirgüç-Kunt & Levine, 2002). Between 1991-1992 and 2000-2001 there has been an increase in competition with the Herfindahl index (a concentration measure) for assets and advances falling more than 28% and 20% respectively (Koeva, 2003). A private bank viz., ICICI has emerged as the second6 just within a span of ten years since they came into existence. If the LLSV is taken into consideration, the horizontal axis indicates the score of the overall total of shareholder rights, creditor rights, government corruption and rule of law. Similarly, the vertical axis score reveals the score of the distance of the nation's external market (domestic firms/pop, external cap/GNP, Debt/GNP, Log GNP and IPOs/Pop to the mean of all nations. A figure that is positive (negative) reveals that the overall score of a nation is higher (lower) than the mean. As compared to Asian nations, the banking system in India has done comparatively well in managing the problem of NPL. The Indian banking system reflects a healthy status partially due to the fact that they established high standards while choosing borrowers (lack of sufficient funding and the strict standards established by banks have been severely criticized by several firms). Nonetheless, the aspect of "ever-greening" of loans has become a matter of concern in order to avoid being slotted as NPLs. Similarly, as compared to the banking sector in other Asian economies, the Indian banking sector has been lucrative in terms of profit too (Jain & Bhanumurthy, 2005).

As per the current trends, it has been noticed that nationalized banks are gradually being replaced from their preeminent position by private banks. While the State Bank of India has managed to retain its position as the largest government owned bank in India, the retail banking sector has witnessed the emergence of private banks like HDFC bank, Axis Bank (formerly UTI bank) and ICICI that have now become major players. While each of these private banks took root with the help of financial institutions backed by the government, these private banks come across as professional enterprises driven by profit. The number of Non-Performing Assets (NPAs) within the loan portfolios of banks clearly indicates the current health of the banking industry. This is critically significant for the economic health of the nation. While foreign banks have been known to have the healthiest portfolios, nationalized are a complete contrast, however, this downward trend over the board can certainly be a positive aspect. Though there is scope for improvement, the existing ratios on the whole are not that alarming specifically in comparison with other Asian nations. Changes were not just restricted to the banking sector alone in fact, there has been a turbulence in the equity markets too. The era succeeding reforms experienced higher returns in the average stock market on the whole as opposed to the era before reforms. From the time the reforms were first implemented, the spread of 'equity culture' through the nation is at a higher degree than earlier.

The BSE market capitalization to the GDP is clearly evident through this trend. While the growth of GDP has been rapid as compared to earlier, there has been a substantially higher growth in equity from a long-term perspective10. The growth in prices of stock (and the related reduction in equity costs) was complemented by a surge in the quantum of funds raised through the issue of debentures as well as stock. This trend began from the time reforms were implemented and the same trend continued for more than five years (figure 1). But it hasn't been smooth sailing throughout. Post liberalization, the Indian stock market bubble has been burst at least twice in a major way. The reliability of the equity market institutions were raised during the first such instance that coincided with the initial reforms. Another crisis hit the bourses in 1998 and in 2001 notwithstanding a joint parliamentary committee investigation and major media attention. A key role in these recurring crises was played by diverse institutional issues and rather than fixing it proactively, it was done in a reactive manner. A feature that is unfortunately quite common in India as compared to developed nations is the issue of proper monitoring of bourses and foul play. As a result, whenever there is a sudden increase in stock prices people get concerned about an imminent drop in rates. Over a period of time, institutions have not only become more transparent but they have also improved. As a matter of fact, the Indian scene is now well established with derivatives and the 'badla' system of rolling settlements that existed since time immemorial has ceased to exist (Pradhan, 2009).

Since the time of liberalization, the advent and phenomenal growth of equity derivatives have certainly proved to be a decisive change within the Indian financial realm. Though the move was met with some resistance from the part of traditional brokers within Indian exchanges, trading in options and futures in India commenced at the turn of the century. The fast paced growth in turnover within NSE derivatives market that was split up into diverse types of instruments is clearly evidenced through figure 1.15. Apparently future - in individual stocks as well as index have proved to be more in demand than options. Nonetheless, there has been a phenomenal growth on the whole in less than five years. Though interest rate futures that were tradable have also made their presence felt, but the volume of trading has been rather sporadic and negligible. Along with Interest Rate Swaps and Forward Rate Agreements, the domain of fixed-income derivatives has also experienced significant growth and is being regularly used not only for hedging corporate risks but also for inter-bank transactions.

Indian companies have also been known to largely utilize forward contracts, currency options and currency swaps to evade currency risk. In recent times, a surge in activity has also been noticed in the Indian market for corporate control. The legal and institutional aspects of investor protection within India has been covered in the following section (Sahoo, 2013). NBFC's accepting public deposit (NBFC's-D) and NBFC's not accepting public deposits are the types of NBFC are which are mentioned above. RBI defines operating leasing entities a leasing company since operating lease is not 'equipment leasing' business as the company does not come under RBI's definition. Equipment leasing is the only financial leasing is included in RBI's definition. The size of the asset of NBFC's is further classified. System investment and non-systematic investment NBFCs based on the size of the asset are also classified in NBC'S-ND .3/4 Systematically importance of NBFC's-ND is overviewed by Indian NBFC sector Bothra and Sayeed (2011) performance in 2010, prospects in 2011 Vinod Kothari and company legal update. Systematically important NBFC's-ND (NBFC-ND-SI) should show Rs100 crore and more in its last audited balance sheet. Minimum CRAR of10% is maintained by NBC'S-ND-SI. Lending to any single borrower/group of borrowers exceeding 15 per cent/25 per cent of its own fund; b) invest in the shares of another company/single group of companies exceeding 15 per cent /25 per cent of its owned fund and; iii) Lend and invest (loans/investments taken together) exceeding 25 per cent of its owned fund to a single party and 40 per cent of its owned fund to a single group of parties is allowed by No NBFC-ND-SI. Non systematically important NBF's-ND (NBFCND-SI) considered when the asset size does not exceed over 100 crores as per last audited balance sheet. Since the last decade, the above table shows the trend of registration of NBFC's with Reserve Bank of India.

Role of NBFC

The role of NBFC has been deemed vital in the robust growth and effective functioning in the economic development. The well-functioning financial system is necessary for thriving modern economy by a universal agreement. Financial services act as a critical pillar in contributing to macroeconomics stability and sustained economic growth in the advanced economy (Randall, 2010). The savers and investors could place choice of instruments as due to the development of the financial market. The investors could place their funds for more enhanced returns in comparison to the bank deposits due to further development of NBFC's. NBFC's are more popular among the lower and middle-class population including India due the various schemes offered (The World Bank, 2003). NBFC's development around the world is recognised especially in the aftermath of repeated emerging market crises in the countries with the bank-dominated financial system. In the developed financial market its provides access to finance for development of firms and individuals at a reasonable cost, reduced volatility and distortions by operating in an environment according to the report of (The World Bank, 2003). The participation of NBFC's has been made possible for widening financial system as a whole. The development of NBFC's thus challenged the banking sector to improve quality and efficiency and deliver at flexible timings and competitive prices (The World Bank, 2003). NBFC were hence the first to enter the un-traded market and also the first to develop the market before the banks entered this field. The NBFC's foreign loan against gold jewellery for the first time following which the national banks entered the market to offer such an asset loan (Mohan, 2014).

NBFC's first started lending money to small traders and small transport operators and financing used commercial vehicles. Many financing companies were pioneered by NBFC sector such as lease fiancé, venture capital finance, financing and transport to name a few, which made NBFC's to play a major role in business of securities that is based on lending such loan against shares, margin funding, Initial Public Offering (IPO) financing, promoter and so on. According to the report by a task force appointed by FICCI, the NBFC encourage retail participation in public sector .NBFC's has taken housing finance to newer heights. NBFC's also played an important role in wider reach of microfinance. Effectiveness as an engine for economic growth and enhancing the financial system capacity to absorb is for the development of such alternative financing vehicles adds the liquidity and diversity of the financial system. Sound and Stable financial statement and development of both sectors over both sectors offer important synergies are the key prerequisites for non-bank financial intermediaries (Jeffrey & Pomerleano, 2002). The rapidity of non-bank financial services is more than the deposit /lending activities of the commercial bank. Accepting deposits and providing loans to non-traditional banking activities has been sought to diversify from the traditional commercial banking system. Enhanced equity and risk-based products are offered by NBFC's. The growing demand for property ownership, small-scale investment and saving for retirement and a growing need for housing fiancé, contractual savings, insurance services, and pension plans management and asset management has reached the stage of discernible economic development due to the rise of the middle class in India. As the commercial banks in India is not functioning as a full pledged universal banking because the banking system cannot meet the requirements (Reserve Bank of India, 2017). The requirements are being met opening banking financial subsidiaries by all major banks in India. Accessing financial services enhances the competition and diversification of the financial sector is the crucial role played by NBFC's for broadening the access. The NBFC's plays the role as a catalyst in the economic growth and also provide proactive regulatory policies as well as economic development (Vadde, 2011).

An Overview of the Indian NBFC Sector

Debentures borrowing from banks and FLs, commercial paper and inter-corporate loans are the funding sources of NBFC's. Directly and indirectly, a bank is also a major source of funding for NBFC's. NBFC's makes the banking system vulnerable as it depends on the banks.

Funding by NBFC's

Between the savers and the investors the bank played an important role. A dramatic transformation takes place in the last few decades due to the financial intermediation. The Bank is providing credit for the people to raise fund investment through stock and bond market new financial products and instruments like mortgage and other asset-backed securities financial futures and derivative instruments like swaps and complex option. Allocation of risks and re-allocation of capital to more efficient use are provided by NBFC's to savers to investors. The ultimate lenders who have moved away from the direct participation in the financial markets to participation through a range of intermediaries are due to the increase in the breadth and depth of financial markets. NBFC's account is for 11.2% of the assets of the total financial system in the international market have been mirrored in the financial system in India. In small scale and retail sector, NBFC's has played an important financial intermediary. RBI consists of NBFC's-d and NBFC's-ND with total no of 12630 NBFC's registered with RBI. The largest share of assets and the largest share of deposits were held by the finance company amongst the NBFCs-d segment by the end of March 2010. The funds provides by NBFCs are:

- Commercial vehicles and cars
- Gold loans
- Construction equipment
- Microfinance
- Consumer durables and two-wheelers
- Loan against shares
- Products offered by NBFCs in India are
- Funding of commercial vehicles
- Funding of infrastructure assets
- Retail financing
- Loan against share
- Funding of plant and machinery
- Small and Medium Enterprises Financing
- Financing of specialised equipment
- Operating leases of cars, etc. types of instrument executed
- Loans
- Hire purchase
- Financial lease
- Operating lease (Bothra & Sayeed, 2011)

Significance of NBFC's

The monitory services sector has been found to have enormous growth in India. Commercial banks are not only introduced but non-banking monitor companies are also introduced. Monitory services like loans, chit funds are offered by non-banking financing companies. Due to their performance and growth rate growth, the NBFC's became an important player in economic development, especially in India where the population in the rural areas is 65-70%. The significance of NBFC's is easily understood by the following points.

Size of the sector: Despite slow growing speed in the economy, the NBFC's have grown well in the last few decades. The size of the economy grew 12.5% in March 2013from 2.4% in 2006. The share of the asset will go; further, the GDP would also go further only if the asset of NBFC's will be below 100 crores.

Growth: The banking sector was much below regarding growth rate as compared with NBFC's. 22% is the average growth rate of NBFC. NBFC's growth rate was 25.7% even when the country's growth rate slowed to 6.3% in 2011-12 from 10.5% in 2010-11 (Acharya *et al*., 2013).

Profitability: Every year the contribution of NBFC's is than banking sector. The banking sector is much more expensive than NBFC's which constitutes to why people prefer the NBFC's. Customers are provided cheaper rates of interest by the NBFC's. The rates of non-lending by NBFC's to customers are however much higher than the banking sectors. The credit percentage of banks 21.4% is much lower than the NBFc's24.3%. NBFC's are more popular among the customers than banking sector.

Infrastructure lending: The NBFC's contribute in the lending to the infrastructure projects for the purpose of development of the country like India. The NBFC's earns the profit over the larger period. The projects are very riskier. Due to the risk, many banks feel afraid in lending to infrastructure projects. One-third of the total assets are lent by NBFC' in the infrastructure sector as of March 2013 as compared bank lent only 7.6%.

Promotion inclusive growth: As the sector works for promoting inclusive growth, NBFC's attracts the wide variety of customers both from urban and rural areas. The company provides the fund for rural areas for the development of the country side. Small Ticket loans are also provided for the affordable housing project. The activities of the company help to promote development growth in the country.

As indicated by the Economic survey 2010-11, it has been accounted for that NBFCs overall record for 11.2 for each cent of benefits of the aggregate money related framework. With the developing significance doled out to monetary incorporation, NBFCs have come to be viewed as essential money related middle people especially for the little scale and retail segments.

In the multi-level monetary arrangement of India, significance of NBFCs in the Indian budgetary framework is highly talked about by different boards delegated by RBI in the past and RBI has been altering its administrative and regulating approaches every now and then to keep pace with the adjustments in the framework. NBFCs have ended up being motors of development and are vital part of the Indian budgetary framework, improving rivalry and broadening in the money related area, spreading chances particularly on occasion of monetary pain and have been progressively perceived as correlative of managing an account framework at focused costs. The keeping money segment has dependably been exceedingly controlled, however streamlined approval techniques, adaptability and opportuneness in meeting the credit needs and ease operations brought about the NBFCs getting an edge over banks in giving financing. Since the 90s emergency the business sector has seen touchy development, according to a Fitch Report1 the exacerbated yearly development rate of NBFCs was 40% in contrast with the CAGR of banks being 22% as it were. NBFCs have been spearheading at retail resource sponsored loaning, loaning against securities, microfinance and so forth and have been stretching out credit to retail clients in under-served regions and to unbanked clients (Bothra & Sayeed, 2011).

NBFC's and its Impact on Indian Economy

The global financial crisis brought about a swing on the aspect of liquidity finances that put NBFC's in India in quite a confusing position. While many had the means to convert their liquidities into short term assets, the crisis itself brought a focus on these NBFC's and their operational styles in various segments of the financial sector. Hence, while the global crisis did not impact India's financial system largely, the repercussions of such an event were more evident on the regulatory structures surrounding the sector. The focus also brought to fore the links between these NBFC's and the banking sector. Before the crisis occurred, the regulatory framework for NBFC's occurred in phases of evolution and each phase seemed to be rather generous to the sector as a whole (FICCI, 2013). This can be evidenced in the aspect that all the non-banking entities were encouraged to registration of all entities with minimal capital and also benefits to the sector that were along the lines of the benefits enjoyed by banks. On the other hand, some of the regulations were marred with negative impacts on business such the restriction of funds that took place between the banks and the NBFC's and also the general consensus of the high growth that was taking place in the non-banking sector. In view of this the Thorat committee (headed by Usha thorat) and the Mor committee (Headed by Dr. Nachiket Mor) were pioneers in the evolution of the most recent regulatory frameworks that surround this industry. This was done with repeated discussion and exchanging ideas along with recommendations to policy. The resultant policy however, was found to be quite pleasant for the sector as released by the Reserve Bank of India (RBI) in the November of 2014. In light of this many organisations were of the hope that the classification of non-performing assets would remain the same. This regulation however, saw to it that the extended timelines for implementation of the regulation and the exemption from one-time reconstruction eased the process for them (FICCI, 2013).

Although it can be stated here that this shift in the policies marked quite a turning point for the industry as a whole, the guidelines also mark a change in the regulation that leaned more towards policies that are activity based. As a result of this, the NBFC sector has been able to carve itself a niche area in the largely predominant banking sector of Indian financial arena. It can therefore be stated that the NBFC's is characterised by very diverse players as well as businesses that bridge the informal and formal sectors of economy in India for the area of finance (FICCI, 2013). In this context, the NBFC's can claim the credits that go towards for converting Indians to the use of a formal regulated system of finance.

Background Analysing the Revised Regulatory Framework for NBFCs

As a result of the above, the framework has impacted the borrower behaviour in a positive manner and also aided in the collection of credit related data thereby effectively strengthening the positioning of the finance where the data thus produced and the information can not only be effectively shared but that which can also be accessed by the policymakers along with the other market participants. The specific regulations for NBFC on the whole have been adjusted over time to suit the non-banking industry as the frameworks are largely based on the baking industry. But other pressures for the Indian regulations are to be at par with the global standards even though the non- banking industry here operates on much different standards than their global counterparts (KPMG, 2014). Therefore, the tenacity that exists between a sector that is differentiation and the tendency of the regulations that focuses on driving the standards constitutes to the main challenges of the regulation in the NBFC sector. However, what is imperative here is that the final guidelines for the sector were able to address most of these issues without actually affecting the legalities as well as reducing the effort involved for the participants (Sharma, 2014).

Market segmentation that has thus been based on consumer interface, acceptance of deposits, protection of the consumers, and liability structures not only impact the future growths of the industry but also align the market to the regulatory structures. This is evidenced in an instance where constricting the leverage of non-systematically important NBFC's also exempts them from a Capital Risk Adequacy Ratio (CRAR) and other revised NPA norms; which can further aid in the development of the business models that can balance opportunity, risk and constraint which can eventually lead to sustainability in business (Reserve Bank of India, 2014). It has also been projected that the risk based regulatory framework may aid in neutralising 'regulatory arbitrage' as these opportunities are being tackled with set benchmarks of limited capital thereby making the threshold for systematic ventures uniform but also being applicable groups. On a similar note, NBFC's that accept deposits (NBFC-D) and Asset Finance Companies (AFCs) also get aligned to the deposit and rating requirements. Furthermore, the credit norms for the AFCs are aligned to the systematically important NBFC's. This can be construed as good move in resisting the complete formalisation of the NBFC's (Ernst & Young, 2014).

The uniqueness of the NBFC does however remain their sole advantage of being adaptive to the market demand conditions. In this regard, the formal categories that do not enjoy regulatory benefits do create a challenge. With this in mind it is imperative to discuss the dilution of the NBFC's

Diluting the NBFC

For the purpose of diluting the NBFC, it is necessary to keep in mind the factor asset income requirement at 50%and also not restricting the captive NBFC. Other advantages of diluting include the ability of the regulators to address issues by using the activity based regulation system. In spite of such leeway, there still exists a debate on whether a Core Investment Company (CIC) can be classified as an NBFC. It is interesting to note here that with the lack of the credit concentration norms for NBFC's that accept no deposits and also that are not systematically important, group holding companies may continue to be NBFC's rather than being classified as CIC's. This is also advantageous as the leverage amount is higher in the case of NBFC than that of the CIC; this is even though they fall under the purview of different regulations (Nishith Desai Associates, 2013).

In view of this, the definition of Foreign Direct Investment (FDI) of an NBFC is not yet along the same lines as the definition put forth by RBI. This in turn causes a lot of friction between the foreign investors especially in term of the investment aspects of the sector (Nishith Desai Associates, 2013).

Evolution of the regulatory framework for NBFCs

The year 1964 saw the introduction of the regulation (section chapter IIIB of the reserve bank of India Act, 1934) meant to regulate NBFC-D. Here, there were several experts that evaluated and also supplicated suggestion as to the role that NBFC's would play in the financial. The committee members of note here were the Narasimham committee and the Working Group on Financial committees that was headed by Dr. A.C. Shah. Besides providing the inputs for the future role of NBFC's the expert panel also evaluated for their potential for growth and all the policies that may be introduced to better the sector. Thereby, many of the recommendations that were put forth by this expert panel later formed the very framework for regulation of the NBFC's as it is today (Gandhi, 2014). The emergence of the NBFC's in close relation with other financial entities within this sector in conjunction with the fact that many big NBFC's did fail; the framework was hence revamped with the introduction of prudential norms in the year 1996. Further on, the RBI delineated the deposit and non-deposit accepting NBFC's for which separate prudential norms were introduced in the year 2007. It can hence be stated here that the NBFC norms have undergone several remarkable changes over the last few years with the gaining recognition as systematically important entities in the financial sector. The connections within the sector run as deep as NBFC's being viable for risk which may very well impact all the players as well the entire sector in itself (Adukia, 2014).

In the recent past of the NBFC segment, there has been some consolidation especially in the NBFC-ND-SI segment. This can be evidenced in the fact that the number of NBFCs that are registering with the RBI has been projecting a steady decline with the overall growth in the assets for the same period of time. On the other hand, the asset growth and composition of the NBFC's asset growth have only risen over the years as is evidenced in the asset growth pattern over the last few years. This is the direct result of the NBFCs having carved niches in the segments such as automobile finance, infrastructure finance, gold and personal loans and other capital markets. Meanwhile on the other hand, segments such as the retail capital market, construction, cars, mortgage, gold loan, corporate loans witness a slowdown in the asset quality due to the overall slowdown of the economy and also due to a weak operating environment. However, there has been an increase in a more positive work environment which can be seen in the remarkable drop in the non-Performing Assets (NPA) for the year 2014.

Given the fact that the norms for asset classification have been revised in the recent framework, a rise in the NPA has been thus projected for the future.

The NBFC sector has shown considerable growth on a yearly basis in net profit in the recent past. The projected growth may be expected to continue with the governments as well as RBI's focus on the financial inclusions.

Banks and NBFCs

The share prices of the NBFC's have gone up from 10.7% in 2009 to 14.3% in 2014 for the banking assets which further add to its systemic importance. With respect to the assets, the NBFC's share for assets has been in line with the Gross Domestic Product (GDP) at the current market price which has been on the rise as evidenced (8.4% in 2006-12.5% in 2013).

Funding Source of the NBFC

The rise in the advances for a bank has been seen to be the major contributor towards the funding for the NBFC. The rapid rise in the advances for banks also is slowly increasing the dependency on the NBFC sector. On the other hand, the growing dependency of the NBFC on the bank funding lays stress on the banks. It may also prove to be difficult for the NBFC's as banks can start to refuse the funding in case they have liquidity issues. In light of this, the after effects of the global financial crisis has enunciated the need to broaden the scope for these NBFC and also alter the regulatory frameworks so as to bridge gaps, widen the opportunities and also align the links and dependency of the NBFC to the rest of the financial sector. Therefore, a need arose to further harmonise the framework in order to ensure that the frameworks of NBFC meet the standard objectives of the RBI adequately. This would also ensure that the impact on the business as such were quite minimal that can be spread over time to further minimise any immediate imbalance. The Thorat committee was once again convened for this purpose, so as to identify the risks in the NBFC sector and how to further address them so as to enable for the financial sector to be robust (Gumparthi, 2010).

Journey of NBFC thus far

Principal Business Criteria (PBC) is achieved by all NBFCs NBFC-ND NBFC-D within two years with turning points that are endorsed (March 2014 - 65% and March 2015 - 75%). The RBI can be approached with a detailed plan that would enable them to achieve INR 25 crores in resources within 2 years, providing it is relevant. Either they realize 75% principle business criteria by March 2015 or they can face the prospect of being banned from reimbursement of stores / raising stores asset order and standards of provisioning.

- To be made in a manner that is suitable for banks – Implementing stage-wise

- Provisioning for standard resources was increased from 0.25% to 0.40%. Recovery standards and liquidity necessities
- Maintaining high fluid resources; no liquidity hole in 1 – 30 day pail
- Corporate Governance of NBFC Extending the SARFAESI structure
- Getting prior RBI endorsement for - Any variation in increment or control in shareholding that is more prominent than 25% of value-
- A board of trustees for remuneration to pay officials
- Prerequisites for enhanced revelations for Tier 1 capital sufficiency and risk weights
- To be specific, NBFCs have presentation in areas that are delicate such as capital business sector, products and land to keep up Tier 1 capital at 10% Captive NBFCs-at least 12% of Tier 1 capital - For capital business sector exposures higher danger weights of 150% to be accorded and for business land exposures 125%, grouping multiple NBFCs (Sinha, 2014).

Collection of assets for direction and enlistment. A modified characterization plan was proposed by the report presented by the Thorat Committee which corresponded with liquidity, provisioning and standards of corporate administration and stringent capital ampleness. The Mor Committee was set up in September 2013 by the RBI with an objective to outline a structured vision with regards to monetary lending and other aspects within India. The committee was also entrusted with the task of auditing existing processes, developing new ones, arranging the configuration standards while also ensuring the development of an extensive observatory system that monitored the progress of budgetary incorporation and structuring similar processes throughout the nation. The arrangement of occasions that led to a redesign in the NBFC administrative system is presented through a graphical representation. Taking into account the recommendations presented by the Mor and Thorat Committee and on the basis of the criticism it received, in December 2012 draft rules for NBFC area open remarks were issued by the RBI. Sufficient time to implement the new administrative system was recommended by the RBI in order to avoid disruption. Taking into account the major aspect of suggestions, the changes as proposed by the draft rules encompassed passage point standards, key business criteria; liquidity prerequisites for NBFCs, corporate administration and prudential controls that included standards for provisioning and grouping resources (Agarwal, 2014).

Merging NBFCs into two categories:

1. Main Investment Companies, and
2. diverse NBFCs

- Offering advantages such as; rebates in tax, points of confinement for banks or the necessity for a segment status that facilitated progress in view of expert rata resource premise, unpredictability in structure, risks in funding and credit, estimation of risk and transferring revelation to national and separate banks.
- Wholesale subsidizing imperatives being tended to systematically
- Facilitating an open system that enables speculators to participate in paying off debtors market issuances of NBFCs
- Accessibility and scope to renegotiate plans
- Prerequisites for low capitalization for NBFCs that are claimed outside
- Compulsorily accepting centre keeping money and exposure of anxiety test
- The standards for NPA acknowledgements and provisioning (taking into account standard resources) will be defined taking into account the level of every class that will be benefitted
- Divulging anxiety test and compulsorily choosing centre managing an account
- An evacuation of specific boundaries that hamper the smooth transition of NBFCs into wholesale / national banks
- Temporary rules for NBFCs Mor Committee report, keeping any fresh NBFC application in temporary cessation, Securing / exchanging control of NBFCs need to be endorsed in advance. The administrative structure was liquidated on 10 November, 2014 by the RBI that hinged on the following goals:
- Consistence can be made less demanding by streamlining and harmonizing directions
- Concentrating on directions that are action based without hindering specific areas within the segments that are not particularly dangerous to the wider monetary framework
- Tackling any imminent threats and rectifying administrative loopholes wherever it exists; and
- Reinforcing the revelation and administrative models

The administrative structure that has been re-evaluated in not a material for every NBFCs but it is to NBFCs who have been listed as essential merchants. The surviving directions of microfinance NBFCs and CICs may win in the event they are in conflict with overhauled controls. As per the altered administrative structure, it has been implied that it is essential for all NBFCs to accept the prudential standards that have been accepted, if possible, it can be done in a phased manner according to the course of events as endorsed. In tandem to the commitment made while liquidating the draft rules in December 2012, the RBI made it clear that all administrative changes be implemented in a phased manner in order to prevent any kind of disruption to business. For all NBFCs, the least net claimed assets were Rs. 2 crores. In accordance with the existing law, it was mandatory for NBFCs that enrolled post April 21, 1999 to have least net claimed stores (NOF) of Rs. 2 crore. Nonetheless, a large number of NBFCs that enrolled prior to that date were permitted to continue maintaining least NOF of Rs. 25 lakh. The fact is that any NBFCs that operate with a base capital that is below Rs. 2 crore are accountable to execute business exercises that are highly constrained in case there are any. Keeping in mind the fact that a higher NOF is needed for annexing innovation that is cutting edge, also it is also to ensure the right base capital for the diverse exercises that are directed by NBFCs. As of now, it has been made mandatory to maintain a base NOF of Rs. 2 crores for every NBFC irrespective of whether they have enrolled prior to or after April 21, 1999. As a matter of fact, it is essential for every

NBFC to realize a base NOF level of Rs. 1 crore before the end of March 2016 and Rs. 2 crore before the period of March 2017. The RBI is yet to issue a notice that rectifies the existing directions. Apprehensions exist in certain aspects with regards to the date from which particular controls must be implemented in the event when no specific course has been suggested. This perspective is most likely to be cleared through a warning from RBI. The extraordinary development in the NBFC division in tandem with its growth amongst linkage and reliance with other diverse organizations with monetary functions has compelled stringent directions to be presented with a view to cover the dangers. This includes RBI's control with regards to NBFCs that don't essentially present a systematic threat to the monetary market. Nonetheless, directions that are not to robust also presents the scope for disturbing elements remaining undetected which can generate unwanted results for the monetary structure. As per the existing directions, NBFCs were arranged such that they accompany three gatherings, fundamentally for regulatory reasons:

- Depositing tolerating NBFCs
- NBFCs with resources under Rs. 100 crore that are non-store tolerating
- NBFCs with resources of Rs. 100 crores or more that are non-store tolerating

With a view to establish a balance amongst over-control and under-control, the edge resource size has been expanded by the RBI for NBFCs to be perceived as critical systematically (NBFC-ND-SI) from Rs. 100 crore or more to Rs. 500 crore or more2. Other than that, a structure that has been rearranged to facilitate light touch direction was established for NBFCs that are not imperative systematically (NBFCs-ND) i.e., NBFCs with absolute resources well under Rs. 500 crore. A total of 12,029 enlisted NBFCs existed out of which store tolerating NBFCs totalled 241; this was the figure as on March 31, 2014. Out of the NBFCs that were non-tolerating, a total of 465 NBFCs were having resources that totalled Rs. 100 crore or more, while 314 NBFCs held resources ranging from Rs. 50 crore to Rs. 100 crore while 11,009 were said to have resources under Rs. 50 crore. Considering the changed limit that was set at Rs. 500 crore, around 11,598 out of the aggregate 12,029 enlisted NBFCs were expected to be termed as NBFCs that were vital non-systematically. A major portion of the NBFC segment was expected to be secured through the streamlined structure in this manner. As of now, 275 elements that were NBFCs-ND-SI, were supposed to be termed as NBFCs-ND following which they would be accountable to controls that were less stringent. As a result, it would facilitate the capacity for transfer of data within the RBI in order to synchronize significant administrative centre onto NBFCs that had a comparatively greater resource size (Kaur & Tanghi, 2013). Till this time, recommended directions for NBFCs depended on whether it was essential systematically or something else. On the basis of their characterization, every NBFC was expected to adhere to the complete controls for instance, the Fair Practice Code, point by point prudential standards, return filings, Know Your Customer (KYC) standards and thus giving rise to an enhanced consistence problem for NBFCs that had specific business exercises. For example, under controls that existed earlier, a NBFC was only drawn in when it came to investing resources into shares and in addition was supposed to set up KYC approaches and receive the Fair Practices Code. The altered structure of administration has looked into this aspect by arranging NBFC-NDs by considering their entrance to client interface and open assets. From a detailed aspect, under the modified administrative structure, NBFC would be categorized and further sub-arranged in the following manner: Total enlisted NBFCs Non-store tolerating Deposit tolerating NBFCs-ND-SI NBFCs-ND 12,029 11,788 241 190 11,598 NBFC-D NBFC-ND-SI NBFC-ND having open asset access and client interface, while they would be able to access open subsidies, they would not be privy to client interface, though they might have client interface, they may be deprived of entry to open assets, they will not be privy to client interface or entry to open assets2 which is anticipated at Rs. 1000 crore according to the draft NBFC rules and the report by the Thorat Committee. Recommendations by the Thorat Committee implied that it was necessary to deem NBFCs that might be a part of a solitary corporate gathering 3 or those that have been segregated by a common arrangement of promoters need not be considered from a stand-alone perspective for supervisory and administrative objects. Instead, they should be considered on the whole. In tandem with the proposal, the newly evaluated administrative system encompassed the whole of the aggregate resources of all NBFCs within a gathering (including NBFCs-D) to determine the supervision and classification of NBFC as NBFC-ND-SI or NBFC-ND.

If the size of the resources of all NBFCs within the gathering is more than Rs. 500 crore, then each NBFC in the gathering would require to be agreed to the regulations pertaining to a NBFC-ND-SI. Based on the directions of the re-examined system, the consolidated resources of the NBFCs in the gathering which even include store tolerating NBFCs should be accumulated to find whether the combination of such results in each NBFC of the gathering could be arranged as NBFCND or NBFC-ND-SI. The RBI system bars the companies that are enrolled as essential merchants from the acquisition of the revamped structure which is subsequent to the essential merchant's business operations which is unique in the relation to the speculation or loaning of NBFC. In any situation, there is no specific prohibition of the total NBFCs which as listed as essential merchants inside the gathering. In the same way, with the CICs putting resources into the auxiliaries of the NBFCs, the total assets present inside the gathering could again recollect the same assets which will lead to the collection of the assets twice. Hence, it is the responsibility of the Statutory Auditors to confirm the size of all the NBFCs in a gathering with the end goal to collect the significant benefits of the NBFCs in a gathering (Gandhi, 2014). In scenarios wherein there are unique inspectors for the different NBFCs within the same gathering, the evaluator of a specific NBFC could not be in a position to repeat the size of various NBFCs in the gathering which makes way for challenges. It would be feasible for the RBI to elucidate the totalling of resources of CICs and NBFCs. Further, there is no specific time period that has been given to consistence by NBFCs-ND (inside a gathering) affected by these procurements. The organisations in the gathering are characterised by a game plan which includes more elements that are identified with each other through the following connections:

- Subsidiary – guardian [defined as far as Accounting Standard (AS) 21]
- Joint endeavour (characterized as far AS 27)
- Associate (characterized as far AS 23)
- Promoter – advance as gave in the SEBI (Acquisition of Shares and Takeover) Regulations, 1997 for recorded organizations,
- Related gathering (characterized as far AS 18)
- Common brand name, and
- Investment in value shares of 20% or more

There is a threat in the form of practical challenges that may emerge during the actualisation of the statutory examiner accreditation necessity. One feasible option is to acknowledge the declaration from any chartered accountant in order to confirm the sie of the NBFCs in the gathering. Based on the prudential standards of the NBFC, 'open assets' ias characterised as an expression to incorporate the assets that are raised through open stores, business papers and debentures between corporate stores and bank account. As an action towards liberalisation, the meaning of open assets has been amended in order to avoid the reserves raised by the issuance of instruments that could be converted into offers inside a period of not surpassing 5 years from the issue date. The controls that are recognised characterise the open assets to incorporate assets either specifically or in a roundabout manner. The phrase 'roundabout manner' could be instantiated with a simple example: A non-NBFC company opens finances and then collaborates them with an NBFC subsidiary as an obligation. This shows the activity called roundabout access to the open assets. It should be noted whether the following situations could be translated to open assets through circuitous access.

- The non-NBFC/CIC saturate their assets as value into the NBFC auxiliary
- The non-NBFC/CIC collaborates with its own assets in its backup NBFC auxiliary through the method for obligation or obligation instrument.

The amended administrative structure has revealed another idea known as the leverage ratio. This is the feature belonging to the restricted prudential standards and is material to all the NBFC-NDs that are accountable to the prudential standards. This NBFCs-ND should guarantee 7 times as an influence proportion wherein all the external liabilities do not surpass the assets possessed. Such a prerequisite would interact with the development of these NBFCs to their capital. In terms of influence proportion, the term 'Outside Liabilities' is not specified in the RBI roundabout where it has been furnished (Reserve Bank of India, 2011).

No definition is discerned under the current NBFC (Non-Deposit Accepting) Companies Directions, 1997. The Core Investment Companies (Reserve Bank) Directions, 2011 (CIC controls) do specify outside liabilities as the absolute liabilities that show up in the side of liabilities on the accounting report, barring 'stores and overflow' and 'paid up capital'. The instruments are necessarily convertible into value offers inside a period not surpassing 10 years from the issue date which includes all types of commitments and obligation and the insurance estimation that are issued and whether these are shown in the monetary record.

Disentangled Reporting

It is deemed that NBFCs-ND which even includes speculation organizations are required to submit a yearly give back arranged; however, the points of interest are to be advised. This is an appreciable move wherein the trouble of consistence is lessened on these NBFCs and at the same time helps the controller monitor the exercises of these organisations (Shakti Sustainable Energy Foundation and CRISIL Infrastructure Advisory, 2014).

Access to open assets and client interface

Based on the altered administrative structure, as a standard, the NBFCs-ND should agree to the restrictions stated in the prudential standards if they hold admittance to open assets. Furthermore, they should consent to lead control of business in situations if they hold a client interface. Restricted prudential standards would basically integrate the prudential standards other than the credit fixation standards and standards on capital ampleness. The controls that are secured under 'Behavior of business directions' are not independently characterized. "Open Funds" encompass reserves that are raised particularly or by implication through open stores, debentures and business papers between bank account and corporate stores; however reserves that are raised by issue of instruments mandatorily convertible into value offers inside a period not surpassing 5 years from the date of issue are rejected. The expression "Behaviour of business directions" characterised by the incorporation of Fair Practices Code, KYC, and so on yet has not been incorporated. It would be viable to open assets to decide the suitability of the prudential standards and the emphasis in this context is laid upon the elucidation of 'roundabout access' to outline the phrase and clarify the term (Gandhi, 2015).

The term 'outside liabilities' is characterized with the end aim of computing the proportion of influence. The definition that is provided by the CIC directions could be considered with a specific end aim to orchestrate both the controls. The changed regulations for NBFCs-ND 14 increased the Tier I capital for capital adequacy purposes. For the NBFCs-ND-SI, the tier I capital has been extended to around 10 per cent. The stages are accomplished by percentages wherein the capital percentage was 8.5 per cent before the end of March 2016 and 10% before the end of March 2017. The definition for open assets under the NBFC structure re-examined avoids the stores raised by issue of instruments obligatorily convertible into value offers inside a period not surpassing 5 years from the date of issue. As the structure avoids the conversion of instruments into offers with a period of no more than 5 years from the issue date, it should be comprehended whether the instruments are the major aspects of claimed reserves. In this case, the meaning of Tier I and claimed assets could be probably changed with the purview of incorporating such instruments. The credit concentration standards for NBFCs ND-SI also remain unchanged though the operations of NBFCs and AFCs remain the same. The standards for NBFCs-D and NBFCs-ND-SI have been changed to that is appropriate to banks by converting the 180-day standard to a 90-day standard. The amended standards for resource management is evident from the procurement for these resources which is improved from 0.25% to 0.40% of the standard advantages estimation. The standards that are modified should be in consistence and accomplished in stages before the end of March 2018. Though the changes are prone to positively affect the revenue of NBFCs in an overall scale and improve the operation costs, these changes are mere modification for the purpose of bookkeeping (Kumar *et al*., 2015).

In addition, around 190 NBFCs (which are NBFCs-ND-SI) will be impacted by these provisions out of which many foreign owned NBFCs, in any case follow stringent norms which are based on their internal policies. Instruments that are compulsorily convertible into equity shares within a period of 5 years are exempted from the definition of public funds. In such a case, there arises a question whether such instruments could be specifically included in the owned funds. Non-Performing Assets Sub-standard Assets - as NPA for a period not exceeding Doubtful Assets - Asset has remained substandard for a period exceeding Loan assets to become NPA if overdue Lease Rental and Hire to become NPA if overdue March 2016 5 months 9 months 16 months 16 months March 2017 4 months 6 months 14 months 14 months March 2018 3 months 3 months 12 months 12 months 6 "owned fund" means paid up equity capital, preference shares which are compulsorily convertible into equity, free reserves, balance in share premium account, and capital reserves representing surplus arising out of sale proceeds of asset, excluding reserves created by revaluation of asset, as reduced by accumulated loss balance, book value of intangible assets and deferred revenue expenditure, if any.

"Tier I capital" is defined to mean owned funds which is reduced by share investment of other NBFCs and in shares, outstanding loans, debentures, and advances which includes hire purchase and lease finance that are made to and deposits with companies and subsidiaries in the same group which exceeds an aggregate ten per cent of the owned fund. The revised Regulations for NBFCs-ND-SI strengthening the corporate governance and disclosure norms which is in line with those recommended by the Thorat Committee which is set up to study the concerns and issues in the NBFC sector and considers the need for proper corporate governance practices. The revised guidelines of RBI have stringently tightened the disclosure and corporate governance norms for NBFC-D and NBFC-ND-SI (Gandhi, 2015). The proper governance and fit for Directors Constitution of Audit Committee, Nomination Committee and Risk Management Committee Appropriate policy in accordance with prescribed guidelines Rotation of partners of audit firm every three years Information Systems Audit should be conducted at least once in 2 years in order to assess the operational risks.

The disclosure norms for authorisation/ Registration/ licence/ are obtained from various information from the financial sector such as country of operation and joint venture partnership with respect to Joint Ventures and Overseas Subsidiaries Ratings assigned by credit rating agencies and migration of ratings during the year Penalties, if any, levied by any regulators Asset liability profile, extent of financing of parent company products, NPAs and movement of NPAs, details of all off-balance sheet exposures Structured products issued, securitisation/ assignment transactions etc. The regulations that are imposed for NBFCs-D are similar to that of the NBFCs-ND-SI since the key concern of the RBI is to protect the interests of the depositors. The norms that are applicable to the NBFCs-D also apply to NBFCs-ND-SI. The Mandatory limits and ratings on the acceptance of deposits for the deposit-accepting AFCs was comparatively less strict than the deposit-accepting NBFCs.

The acceptance to public deposits was allowed for unrated AFCs also. Furthermore, also high limits for deposit acceptance and credit concentration are also enjoyed by the deposit accepting AFCs. However, the AFC regulations are now in line with those that are regulated for other deposit-accepting NBFCs. Existing unrated AFCs will be requiring an investment grade rating by March 31, 2016 in order to accept deposits. In the intervening period to March 31, 2016, only renewal of existing deposits on maturity could be performed by the unrated AFCs and no fresh deposits could be accepted till an investment grade rating is obtained. The threshold limit for deposits by deposit accepting AFCs is reduced from 4 times to 1.5 times of the net owned funds (Jain & Bhanumurthy, 2005).

Change in management and control of NBFC

The recommendations of the Thorat Committee states that the requirement to obtain prior RBI approval for management or control change could be extended to NBFC-ND which was incorporated and considered into the RBI issued draft guidelines. All these views are culminated in the issuance of the Non-Banking Financial Companies (Approval of Acquisition or Transfer of Control) Directions, 2014 8 [herein after referred to as 'Change in Control Directions'] which is a step towards ensuring that these non-banking companies are fit and properly managed. In May 2014, the RBI issued Change in Control Directions prior to issuance of the revised regulatory NBFC framework. The stringent provisions for change in management or control were evident for NBFC-D in order to acquire prior written RBI approval whereas for NBFCND only intimation with the regional office of the RBI satisfies the requirement for approval. A key parameter that is considered by the RBI when granting a Certificate of Registration (CoR) to a company for business undertaking as an NBFC company is the proposed management or general character of the management of the NBFC which ensures that the same is not prejudicial to the public interests.

Areas Requiring Clarity

With respect to the ambiguity in the aspects of Change in Control Directions, there is an increase in the delay of timelines and operational challenges. This could only be clarified by the intervention of the RBI. In order to ensure the fit and proper character of NBFC management, RBI should ensure Change in Control Directions for both pre and post change in control. Change in management or control of NBFCs 8 DNBS (PD). C. No.376/03.10.001/2013-14 dated May 26, 2014 Prior written permission of the RBI + 30 days prior public notice Merger/amalgamation of an NBFC with another entity or vice versa that would give the Merger/amalgamation of an NBFC with another entity or vice versa which would result in acquisition/ transfer of shareholding in excess of 10% of paid up capital of the NBFC Before approaching Court/Tribunal seeking an order for mergers/amalgamations with other companies or NBFCs Takeover or acquisition of control of an NBFC, whether by acquisition of shares or otherwise If "Control" is considered as the operative word of the Change in

Control Directions. The Change in Control Directions will cover cases where such changes in the control are based on the prescribed definitions of the SEBI (Substantial Acquisition of Shares and Takeovers), Regulations 2011 (SEBI Takeover Code). If the operative word is said to be control, then the pre-requirement for the triggering of RBI approval tends to be acquisition / transfer of control. In the same context, the transfer or acquisition of shareholding without a corresponding transfer of control does not require the approval from RBI.

Following are the transactions that do not require approval from RBI at the time of initial acquisition as there is no amendment in management or control:

- Acquisition of convertible instruments (e.g. compulsorily convertible preference share)
- Acquisition of equity shares without a corresponding acquisition / transfer of control; and

The emphasis of Change in Control Directions (Control Vs. Shareholding) with respect to the application of framework in situations that are covered by the RBI remains unchanged which reveals the state of unclearness whether the Change in Control Directions could be applicable to cases where there is no change in the control at an overall group level or there is a change but control remains existing among the shareholders of the NBFC. Approval in this scenario priot would impact the timelines on transactions which could be stated as follows:

- Internal group restructurings where the control stays within the group; or
- Transfer of shareholding by existing shareholders of the NBFC

In situations where the control is within the same group then the RBI would have already considered a detailed due diligence and the group would comply with the 'fit and proper' criteria; and there will be effective change in the management or control of the NBFC. In transactions where the control ultimately remains status quo should be excluded from the needs of acquiring the approval prior from the RBI as per the Change in Control Directions. This type of exclusion would provide the necessary relief for the structuring or restructuring transactions. A 10 % of threshold for change in control – constitution and limit for paid up capital constitutes a change in management or control through amalgamations or mergers. There is no prescribed threshold for transactions other than mergers/ amalgamations. The paid up capital of an NBFC could include the securities and instruments that are void of voting rights and will not result in any effective change in NBFC control.

In this context, the paid up capital which is considered as the ground on which the threshold should be computed leads to absurd results. This is explained with an illustration below:

- The equity share capital (10,000 shares of INR 10 each) is Rs.1, 00,000 and the redeemable preference share is Rs.9, 00,000.
- The total paid up capital is Rs.10, 00,000. The threshold in this illustration will be 100,000 (10% of 1,000,000). If 50% of the equity shares (voting shares) are transferred by the promoters of the company to a third party, this would reach 50,000 which would still be within the threshold limit of 10% of the paid up capital i.e. 100,000 and hence no RBI approval would be required.

This is not the intention to be covered by the RBI under the Change in Control Directions. Also the prescribed limit currently is 10 per cent under the Change in Control Directions which is very low and affects the completion and execution timelines of a large number of transactions. This is a consequence of the mandatory requirement to seek prior RBI approval. For example, (i) inter-group restructuring, ii) strategic investments by investors in NBFCs in excess of the prescribed threshold of 10% equity stake (without any change in control); (iii) acquisition/ transfer of shareholding of listed NBFCs on the floor of the stock exchange. The threshold limit could be amended to a higher percentage of the paid up equity capital in order to provide improved flexibility of operations to the NBFCs. According to the draft RBI guidelines issued pursuant recommended by the Thorat Committee, a threshold limit of 25 per cent could be considered. Hence, the expansion of the procedures pertaining to corporate governance compliance to NBFC-ND is the step in the correct direction as this ensures the fit and proper management of NBFCs building a character and aids in developing confidence with investor/ customer. However, there should be an improvement in the clarity in the regulations of RBI for the effective compliance and implementation of such changes. In addition, necessary guidance is still lacking hence details of the application process, application format, supporting documentation required, and so on should be prescribed to fresh applications of NBFC in order to ensure transparency and simplicity in the process. This results in the awareness both amongst the applicants and the RBI officials reviewing the application, thereby ensuring the disposal of applications (Government of India, 2012)

Areas Requiring Enhancement

Certain committee reports have recommended changes in certain areas of financial operations. These reports are recommended on behalf of the NBFC sector which requires consideration and deliberation for the benefit of these companies. Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) does not cover NBFCs and the sector is kept outside the purview of the Act. The sector is requesting for benefit extension of the SARFAESI Act which is still an overdue. Though it is evident that public financial institutions such as banks enjoy the benefits of SARFAESI Act, the purview of the act is outside for NBFCs. Both the Mor and the Thorat committee identified the same and had recommended that NBFC companies should also enjoy the benefits of the SARFAESI Act. Many trade associations along with the NBFCs have represented the recommendations to be implemented on the provisions of the SARFAESI Act to registered NBFCs. It is critical to have such reforms based on the SARFAESI Act as the Act enables financial institutions to recover NPAs without the intervention of the court (Pandit, 2011). It would be a long journey for the RBI to implement such amendments under the SARFAESI Act in order to create a level playing field for both banks and NBFCs. The role of NBFCs in the economy is diverse wherein these companies complement banks and broaden the access to finance based resources. This implies the importance of the NBFCs and the need for the sector to be brought under the ambit of the SARFAESI Act is emphasised.

Differential Risk Weights for Capital Adequacy Ratio

Risk weight assessment for capital adequacy requirements by banks takes into account the borrowers' credit rating. Though both banks and NBFCs operate in the same macroeconomic environment, the applicability of such provision is lacking in NBFCs. Even in cases of secure investment or lending where the quality of security is the same as that of banks, there exists no differentiation in the risks weights for NBFCs. In addition, the proposed draft guidelines of the NBFC exposed high risk weights for commercial real estate and capital market sector. The NBFC sector for a very long time is requiring amendments in risk weight allocation and introduction of similar norms such that of the banks. Though differential risk weights are not introduced, the revised regulatory framework has amended the considerations for regulatory foreign investment tax.

- Extension of SARFAESI coverage
- Differential risk weights for capital adequacy ratio
- Access to refinancing schemes
- Simplification and clarity in CIC regulations Foreign Investment
- Challenges in undertaking investment by way of treasury functions by foreign owned NBFCs Tax

10% extension of tax benefits is available to banks to NBFCs capital requirement for the purpose of computing the CRAR which further increases the cost of operations for the NBFCs.

Access to Refinancing Schemes

There is no eligibility for NBFCs in their access to schemes of refinance from National Bank for Agriculture and Rural Development (NABARD), National Housing Bank (NHB), Small Industries Development Bank of India (SIDBI) etc. This is reasoned by the fact that refinancing schemes of these institutions are available to only certain kinds of institutions. This is instantiated by the fact that the eligibility for refinancing facilities is limited by the norms of the NHB; however customers who do not have access to such facilities can be aided with the help of an NBFC. This is a violation of the neutrality norms for NBFCs. The recommendations of the Mor Committee states that the use of refinancing from NABARD, NHB, SIDBI and credit guarantee facilities should be based on the type or nature of the activity and not the type of institution. This concept is not under the direct purview of the RBI as this requires amendments to be made to the other acts based on which these financial institutions operate. However, with the increase in the increasing funding constraints of NBFCs, it is important for the government and the RBI to take measures with regard to the violation of norms. Surplus fund deployment should be construed as financing and the activity of treasury management should be made permissible under the automatic route. Similar to the heading 'stock broking' which is the equivalent term for stock broking business, the term 'Non-banking financing' should replace 'leasing and finance' as it would permit foreign owned NBFCs to undertake the activities that are permitted under the regulations of the RBI and at the same time subject to the norms of the FDI.such as sectorial caps, capitalisation, pricing guidelines, etc.

Lack of Clearness in Regulations

Since the inception of the NBFC sector, the companies belonging to this sector suffer from the lack of clearness in the regulations and hence the regulatory frameworks are not completely supportive. Another important issue with regard to the complication is the definition that is specified for CIC. The existing conditions for an entity to be designated as a CIC are based on the constraints that it could be difficult for the particular entity to undertake business from another entity. However, there are several companies which are group holding. These companies not only are shareholders of the group companies but also undertake business operations in the same entity. With the purview of carrying out business activities in the entity in a smooth way, the framework for CIC should be simplified so that these entities can come forward, register with RBI and also carry business operations with other entities in simple ways satisfying the definitions of the RBI. The challenges in the undertaking of investments through the treasury functions by NBFCs owned by foreign concerns as per the extant FDI policies are that these companies are permitted to undergo foreign investment under the prescribed route based on the 18 non-banking financial service activities. If these companies require undertaking of business operations other than the non-banking financial service activities should acquire approval from the government. This is facilitated through the Foreign Investment Promotion Board.

The norms of the RBI are based on the investing and lending activities permitted only to be performed by registered NBFCs. With respect to the management of liquidity and liabilities, NBFCs also undertake treasury based investments. The extant FDI norms state that only 'Leasing and finance' based NBFCs get covered under the automatic route. Besides, the term finance is not properly defined in the norms of the RBI. Hence considering the basic meaning of the term reveals that 'lending could be covered' but 'investment' activity (both strategic as well as treasury) would not get covered specifically. Since the same act licenses both domestic and foreign owned NBFC companies, the regulations of the RBI state that both are assumed to have the same kind of ability to undertake business. The ambiguity prevailing in identifying the exact meaning for the phrase leasing and finance' has been a challenge in mapping the RBI regulations with respect to the 'Leasing and finance' NBFCs (Government of India, 2012).

It is interesting to note that though there is no restriction for Indian non- NBFCS from investing in such financial instruments, the NBFCS in India with FDI are restricted from such investments which is the cause of lack of proper definitions for the policies with regard to FDI under the regulations for NFBCs. It is hence deemed essential that at least clarified that the Extension of tax benefits to NBFCs similar to that available to commercial banks which the RBI is striving to make both NBFCs and banks have aligned regulatory framework. Such alignment of regulations is recommended by the Thorat committee to have an arbitrage between NBFCs and banks. Based on the recommendations by the Thorat committee, the revised regulatory framework elucidates that the norms of classification and requirements for provisioning are modified for NBFCs to bring these regulations in line with the regulations of the banks. Furthermore, the committee had also recommended for tax-parity between

NBFCs and banks. It is notable that the provisions stated in the Income-tax Act, 1961 (I.T. Act) provide tax relief to financial institutions such as banks; however, such relief are not covered for NBFCs under these provisions.

- Section 43D of the I.T. Act identifies the principle of taxing of income on receipt basis for NPA holders
- According to the regulations issued by the Reserve Bank of India, in line with the other financial institutions NBFCs also follow the norms and are required to accept income with respect to non-performing accounts. If such a norm of the RBI is not covered for NBFCs, the existing tax framework will recognise such income in the non-performing accounts on a regular basis leading to the levying of tax on the income which will not be realised hence leading to severe forms of liquidity in these NBFCs in the form of cash flow pay outs. In addition, factors such as profitability and operations costs could also be affected.
- Section (1) (vii a) of the I.T. Act states that the provisions for the bad debts made by the banks, to permissible limits are tax deductible. In other means, such financial institutions are provided an option to claim such deduction with respect to the provisions made for assets that are marked as loss or doubtful assets. With regard to the recognition of income and provisioning norms, the regulations stated by the RBI for NBFCs are similar to that of the commercial banks. Based on the regulations, it is mandatory that NBFCs should necessarily make provisions for NPAs. It is hence deemed to be appropriate that the fairness of the provision for NPAs be allowed as a tax deduction procedure for NBFCs that are registered with the RBI.
- Section 194A of the I.T. Act elucidates that 10 percentage of TDS should be deducted as an interest of the instalments that are paid to NBFCs; however such deduction is exempted for banking and public finance institutions and are void of such withholding of tax. This leads to the severe cash flow constraints as the operation of NBFCs is based on a very thin margin of interest. Sometimes, the interest rates are even lesser than the TDS.
- Section 72A of the I.T. Act states that at the time of amalgamation of banking companies, the accumulated losses could be carried forward and could be claimed by the amalgamated entity (Government of India, 2012).

However, such benefits are not available in specific to the NBFCs which are lapsing of the losses accumulated upon amalgamation. The uniqueness in the applicability of different tax provisions places NBFCs in a position that is most disadvantageous vis-à-vis other financial institutions such as banks. Hence, it is deemed that the benefits in the form of tax to banks should also be applicable to NBFCs. Tax benefit extension would provide adequate relief to NBFCs which is severely restricted to these institutions due to high funding of costs and tight profit margins. Differentiated licensing of various types of banks will create great vitality in the small scale finance sector which benefits the customers through wide number of products and services and increased penetration; hence, there is an opportunity for these NBFCs to grow. With respect to the funding constraints, the conversion to small or universal banks will be another viable option for the scaling up of NBFCs, their operations and expansion in terms of customer base and access to market. However, such conversion is not feasible for large scale NBFCs since this type of migration without regulatory forbearance could be difficult. Though differential licensing has termed to be an accepted procedure, these NBFCs will be focussing on organisations with attractive business models such that organisations can tap into funding sources. Henceforth, in a growing economy like India, only an implementation of a stable regulatory environment will provide NBFCs the opportunities to grow in the financial ecosystem and create opportunities for employment in the remote areas of the country (Kaur & Tanghi, 2013).

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How to cite this article:

Deepak Kumar and P. Srinivasa Suresh.2017, An Overview of Non Banking Financial Companies In India. *Int J Recent Sci Res.* 8(8), pp. 19127-19144. DOI: http://dx.doi.org/10.24327/ijrsr.2017.0808.0635

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