PERFORMANCE OF NON-BANKING FINANCIAL COMPANIES IN INDIA - AN EVALUATION

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ABSTRACT

Non-banking financial and investment companies operate as an important adjunct to the banking sector in financial intermediation. They provide support to the capital market through investment holding, share trading and merchant banking activities, to the credit market through short and medium-term loans and also help in acquiring long-term assets through lease and hire purchase activities. This article analyses the performance of non-government financial and investment companies (other than banking, insurance and chit-fund companies) during the year 2008-09. The study is based on the audited annual accounts of 1,215 companies, which closed their accounts during the period April 2008 to March 2009. The segment of financial and investment companies in the private corporate sector is highly skewed. The presence of a large sized company, viz., Housing Development Finance Corporation (HDFC) Limited in the study would exert considerable influence on the overall performance of the companies in this group in terms of various quantitative measures. In view of such marked skewness in the size structure, the analysis presented in the article excludes results of HDFC. Further, it is observed that the results of three other companies are in large variance with the remaining companies and accordingly these companies are also kept outside the scope of the study. Thus, the present analysis is confined to 1,211 companies. However, the data on all the select 1,215 companies including HDFC and other three outlier companies are separately presented. The study also presents comparable data for the preceding two years 2006-07 and 2007-08 for the same set of companies, based on the analysis of their accounts for the respective years.
Keywords: Non-banking, share trading, merchant banking, capital market, lease and hire purchase, Housing Development Finance Corporation.

Introduction:

The activities of non-banking financial companies (NBFCs) in India have undergone qualitative changes over the years through functional specialization. The role of NBFCs as effective financial intermediaries has been well recognized as they have inherent ability to take quicker decisions, assume greater risks, and customize their services and charges more according to the needs of the clients. While these features, as compared to the banks, have contributed to the proliferation of NBFCs, their flexible structures allow them to unbundle services provided by banks and market the components on a competitive basis. The distinction between banks and non-banks has been gradually getting blurred since both the segments of the financial system engage themselves in many similar types of activities. At present, NBFCs in India have become prominent in a wide range of activities like hire-purchase finance, equipment lease finance, loans, investments, etc. By employing innovative marketing strategies and devising tailor-made products, NBFCs have also been able to build up a clientele base among the depositors, mop up public savings and command large resources as reflected in the growth of their deposits from public, shareholders, directors and other companies, and borrowings by issue of non-convertible debentures, etc. Consequently, the share of non-bank deposits in household sector savings in financial assets, increased from 3.1 per cent in 1980-81 to 10.6 per cent in 1995- 96. In 1998, the definition of public deposits was for the first time contemplated as distinct from regulated deposits and as such, the figures thereafter are not comparable with those before.

Non-banking Financial Institutions carry out financing activities but their resources are not directly obtained from the savers as debt. Instead, these Institutions mobilize the public savings for rendering other financial services including investment. All such Institutions are financial intermediaries and when they lend, they are known as Non-Banking Financial Intermediaries (NBFIs) or Investment Institutions. Apart from these NBFIs, another part of Indian financial system consists of a large number of privately owned, decentralized, and relatively small-sized financial intermediaries. Most work in different, miniscule niches and make the market more broad-based and competitive. While some of them restrict themselves to fund-based business, many others provide financial services of various types. The entities of the former type are termed as "non-bank financial companies (NBFCs)". The latter types are called "non-bank financial services companies (NBFCs)". Post 1996, Reserve Bank of India has set in place additional regulatory and supervisory measure that demand more financial discipline and transparency of decision making on the part of NBFCs. NBFCs regulations are being reviewed by the RBI from time to time keeping in view the emerging situations. Further, one can expect that some areas of co-operation between the Banks and NBFCs may emerge in the coming era of E-commerce and Internet banking. The RBI regulates NBFCs engaged in Equipment leasing, hire purchase finance, loan and investment, residuary non-banking Companies (RNBCs) and the deposit taking Activity of miscellaneous non-banking Companies (chit funds). With the amendment Of the RBI Act in 1997, it is obligatory for NBFCs to apply for a certificate of registration (COR). As at the end of June, 2004, the RBI Received 38,050 applications for registration. Out of these, the RBI approved 13,671 Applications, including 584 applications of Companies authorized to accept public Deposits. The supervisory role of the RBI Encompasses on-site inspection, off-site Monitoring, market intelligence and exception Reports of statutory auditors.

Data and Methodology:

For the present study data are collected from various issues of RBI Bulletin regarding Financial and Investment companies. This article analyses the performance of non-government financial and investment companies (other than banking, insurance and chit-fund companies) during the year 2008-09. The study is based on the audited annual accounts of 1,215 companies, which closed their accounts during the period April 2008 to March 2009. The segment of financial and investment companies in the private corporate sector is highly skewed. The presence of a large sized company, viz., Housing Development Finance Corporation (HDFC) Limited in the study would exert considerable influence on the overall performance of the companies in this group in terms of various quantitative measures. In view of such marked skewness in the size structure, the analysis presented in the article excludes results of HDFC. The study also presents comparable data for the preceding two years 2006-07 and 2007-08 for the same set of companies, based on the analysis of their accounts for the respective years.

I. Composition of the Select Companies:

The select 1,211 financial and investment companies were classified into five groups, viz., (1) Share trading and investment holding, (2) Loan finance, (3) Asset finance, (4) Diversified and (5) Miscellaneous. A company was placed in one of the first three principal activity groups if at least half of its annual income during the study year 2008-09 was derived from that principal activity consistent with the income-yielding assets. In case no single principal activity was predominant, the company was classified under 'Diversified' group. Companies not engaged in the above three activities, however, conducting financial activities were classified as 'Miscellaneous'3. The composition of the select companies according to their total number, paid-up capital, main income and total net assets across the above-mentioned activities are presented in Table 1.

The 'Share Trading and Investment Holding' companies, which accounted for 41.9 per cent, in terms of number, of the select 1,211 companies, had a share of 30.7 per cent of the total paid-up capital in 2008-09; but accounted for only 12.8 per cent of the total net assets and 14.0 per cent of the total main income. 'Loan Finance' companies (37.8 per cent in terms of number) accounted for 51.6 per cent of total paid-up capital, contributed a major share in total main income and in total net assets at 70.6 per cent and 65.3 per cent, respectively, in 2008-09.

Table -1 **(Amount in ` crore)**

Activity	Number of Companies	Paid-up Capital	Main Income	Total Net Assets
Share trading	507	7,567	4,069	41,171
Investment holding	-41.9	-30.7	-14	-12.8
Loan finance	458	12,736	20,544	2,09,417
	-37.8	-51.6	-70.6	-65.3
Asset finance	42	1,393	1,905	13,806
	-3.5	-5.6	-6.5	-4.3
Diversified	49	410	672	6,503
	-4	-1.7	-2.3	-2
Miscellaneous	155	2,568	1,906	50,038
	-12.8	-10.4	-6.6	-15.6
All Activities	1,211	24,675	29,097	3,20,934
	-100	-100	-100	-100

Note: Figures in parentheses represent percentages to total.

II. Operational Results:

Onset of global financial crisis in 2008- 09 initially led to liquidity problems in non- banking financial companies as their traditional funding sources dried up. However, the liquidity-augmenting measures taken by the Reserve Bank addressed the problem swiftly. Subsequently, demand for credit also came down. On another front, reversal of capital flows in the second half of the financial year put severe pressure on domestic capital market and the investors suffered huge losses. Operating results of non-banking financial and investment companies were also affected.

The main income of the select 1,211 non-government non-banking financial and investment companies increased only by 15.7 per cent in 2008-09 to ` 29,097 crore as against 40.6 per cent growth observed in 2007-08 (Statements 1 and 3). Growth in interest income (which contributed 49.2 per cent to the total income) at 30.8 per cent during the year under review was lower compared with 61.8 per cent recorded in the previous year and net profit from share dealings (contribution to total income is 10.6 per cent) declined by 19.0 per cent. However, the other income (contribution to total income is 25.2 per cent) grew by 34.4 per cent during 2008-09. As a result, total income of the select companies increased by 20.8 per cent in 2008-09 as compared with 46.9 per cent in the previous year.

Interest payments went up by 40.0 per cent in 2008-09 on top of 62.7 per cent growth registered in 2007-08. However, employees' remuneration witnessed a growth of only 14.0 per cent in 2008-09 as against 68.4 per cent in 2007-08. Growth in depreciation provision of 15.2 per cent during 2008-09 was also lower compared with 28.1 per cent growth in 2007-08. As a result, total expenditure went up by 33.4 per cent in 2008-09 as compared with 62.6 per cent growth registered in 2007-08.

Accordingly, operating profits and post- tax profits of the select companies declined by 6.7 per cent and 7.9 per cent, respectively, during the period under review (Table 2). Operating profit margin, measured as a ratio of operating profits to main income, of the select companies decreased to 35.0 per cent in 2008-09 from 43.4 per cent in 2007-08 (Table 3). The return on shareholders' equity (ratio of profits after tax to net worth) of the select companies was lower at 7.8 per cent in 2008-09 compared with 9.5 per cent registered in 2007-08. However, the select companies rewarded their shareholders with marginally higher dividends in 2008-09. The dividend rate increased marginally to 6.8 per cent in 2008-09 from 6.6 per cent in 2007-08. Retention ratio (retained profits to profits after tax) of select companies decreased moderately to 80.3 per cent in 2008-09 from 82.8 per cent in 2007-08 (Statement 2). Bad debts including provisions accounted for a higher share of 5.3 per cent of total income in 2008-09 as against 4.4 per cent in the previous year, indicating deterioration in assets quality of the select companies.

While the companies across all the groups recorded lower profits, those engaged in miscellaneous financial activities, could post positive growth in their operating profits and post-tax profits in 2008-09. Companies in 'Share Trading and Investment Holding' activity and 'Diversified' group were most adversely affected in terms of growth in net profits. The companies engaged in miscellaneous financial activities registered the highest operating profit margin followed by the companies dealing in 'Share Trading and Investment Holding' activity. The dividend rate was the highest for the companies engaged in miscellaneous financial activities.

III. Sources and Uses of Funds Sources of Funds:

Faced with a recessionary prospect world-wide, business of non-banking financial and investment companies expanded at a slower pace. The select companies raised funds amounting to ` 44,947 crore during 2008-09 as against ` 86,348 crore raised during the previous year (Statement 5). Funds raised through external sources declined to ` 30,251 crore from ` 74,250 crore in the previous year.

Table-2: growth Rate of Select Items, 2007-08 and 2008-09

Activity Item	All Activities		Share Trading & Investment Holding		Loan Finance		Asset Finance		Diversified		Miscellaneous	
	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09
Main Income	40.6	15.7	-10.9	-3	63.6	28.3	41.2	27.3	27.5	-12.7	54.8	-28.6
Total Income	46.9	20.8	-6.5	-6.3	61.5	28.4	48.9	23.4	31.9	6.8	71.2	21.1
Total Expenditure	62.6	33.4	49.1	-4.2	67.8	43.9	43	31.2	32.2	17.9	65.9	25.3
Operating Profits	24.9	-6.7	-25.9	-5.8	55.8	-9.3	84.8	-44.3	17.6	-33.3	95.8	5.4
Profits After Tax	18.4	-7.9	-20.5	-14.8	39.4	-8.6	63	-4.3	42.1	-48.9	88.9	8.2

Table 3: Select Profitability Ratios, 2007-08 and 2008-2009

Activity Item	All Activities		Share Trading& Investment Holding		Loan Finance		Asset Finance		Diversified		Miscellaneous	
	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09
Operating Profit Margin	43.4	35	68.7	66.8	32.2	22.8	23.7	10.4	21.3	16.3	87.7	129.7
Effective Tax Rate*	26.3	28.1	15.9	19.7	28.2	29.1	30.5	33.9	26.9	38.2	11.4	11.1
Return on equity	9.5	7.8	9	7.1	8.3	6.7	10	7.6	6.4	3.1	18.8	16.4
Dividend Rate	6.6	6.8	4.3	8	7.2	5.6	6.2	3.3	3.2	3.4	12	11.9
. Return on Assets	3	2.4	6.5	5.2	2.2	1.7	1.7	1.6	2.2	1.1	3.7	3.3

Calculated based on the companies which made profits during that year.

Accordingly, the share of external sources in total sources declined to 67.3 per cent during 2008-09 as against 86.0 per cent in the previous year (Table 4). The share of funds mobilised from capital market through issue of fresh capital (including premium on shares) in the total sources of funds decreased to 12.7 per cent during 2008-09 from 22.9 per cent during 2007-08. Similarly, share of borrowings declined to 52.0 per cent during 2008-09 from 56.8 per cent during 2007-08. The share of 'Debentures' in total borrowings remained close to 28 per cent, whereas, the share of 'Bank borrowings' in total borrowings decreased to 55.6 per cent during 2008-09 from 59.1 per cent in 2007-08.

IV. Liabilities and Assets Structure :

Liabilities Structure:

The total liabilities of the select companies increased by 15.8 per cent to ` 3,18,167 crore in 2008-09 (Statement 4). Though Borrowings (outstanding) grew at a lower rate by 13.8 per cent in 2008-09, it continued to be the major component, constituting 60.5 per cent of total liabilities (Chart 1). The share of bank borrowings in total borrowings marginally increased to 44.7 per cent in 2008-09 from 43.2 per cent in the previous year. The debt-equity ratio marginally increased to 106.2 per cent in 2008-09 from 105.6 per cent in 2007-08. Total outside liabilities grew at a higher rate (17.0 per cent) compared with net worth (13.1 per cent). As a result, the ratio of total outside liabilities to net worth increased to 226.9 per cent in 2008-09 from 219.4 per cent in 2007-08. The composition of total liabilities of select companies across activity groups is given in Table 4.

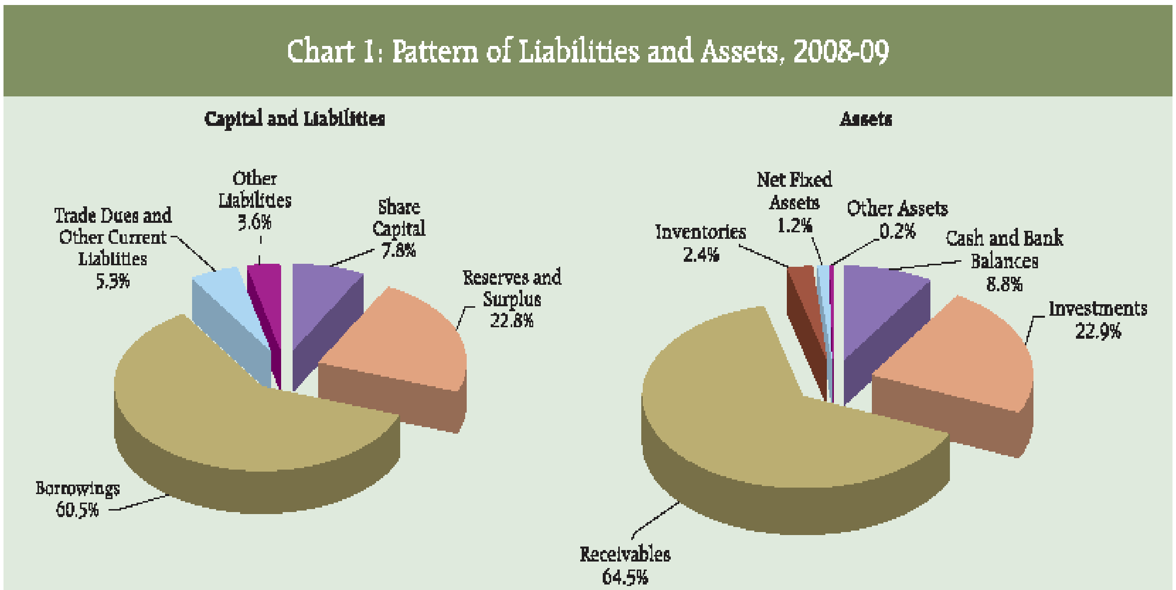
Assets Structure:

The assets pattern of the select companies showed marginal variation in 2008-09 from that of previous year (Table 6). While the share of 'Loans and Advances' extended by the select companies in total assets decreased to 60.9 per cent in 2008-09 from 61.7 per cent in 2007-08, the share of 'Investments' in total assets increased to 22.9 per cent in 2008-09 from 22.0 per cent in 2007-08. Investments and loans and advances extended by these companies grew at a lower rate by 20.6 per cent and 14.3 per cent, respectively, in 2008-09 compared with 42.6 per cent and 45.2 per cent, respectively, in 2007-08. The ratio of borrowings to total assets decreased to 60.5 per cent in 2008-09 from 61.5 per cent in 2007-08.

Table 4: Liabilities Structure of Select Financial and Investment Companies, 2007-08 and 2008-09

Capital and Liabilities	All Activities		Share Trading &Investment Holding		Loan Finance		Asset Finance		Diversified		Miscellaneous	
	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09
A. Share Capital	8.2	7.8	19.3	18.4	6.5	6.1	7.3	10.1	6.7	6.4	5.6	5.1
B. Reserves and Surplus	23.1	22.8	52.5	54.6	19.6	19	9.9	10.4	28.1	28.2	14.1	15
C.Borrowings	61.5	60.5	22.4	19.6	68.7	66	68.4	70.6	44.7	43.3	67.8	69.9
i. Debentures	18.3	17.8	3.8	3.5	22	20	29.1	40.5	10.3	5.9	14	15.6

ii.Bank borrowings	26.6	27	5.8	6.3	28.1	28.1	28.2	16.2	24	25.7	39.2	42.4
D. Liabilities	5.7	5.3	4.7	6.3	3.7	3.7	13.4	8	18.5	20.6	11	8.3
Sundry Creditors	1.9	1.6	2.2	1	1	1.2	4.8	3.5	2.6	2.4	4.4	3.4
E. Other Liabilities	1.5	3.6	1.1	1.2	1.6	5.2	1	0.9	2	1.4	1.5	1.6
Total	100	100	100	100	100	100	100	100	100	100	100	100



Borrowings (outstanding) continued to be the major component in the total liabilities for all the groups of companies, except for the companies engaged in 'Share Trading and Investment Holding' activity, for which reserves and surplus was the major component. Major contributor in total borrowings was debentures in case of companies engaged in 'Asset Finance'activity, whereas, for other companies bank borrowings was the major contributor.

The assets structure of the select companies was in line with the major activity undertaken by them. Investments accounted for a major share of 58.0 per cent in total assets for companies in 'Share Trading and Investment Holding' activity, whereas, loans and advances extended formed a major share for companies engaged in 'Loan Finance' and 'Asset Finance' activity at 70.4 per cent and 80.2 per cent, respectively, in 2008-09.

Table -5: Assets Structure of the Select Companies

Assets	All	Share	Loan Finance	Asset	Diversified	Miscellaneous

	Activities		Trading &Investment Holding				Finance					
	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09	2007-08	2008-09
A. Cash and Bank Balances	8.3	8.8	4.3	7.8	8.8	6.3	7.5	10.1	6.2	3.3	10	20.4
Deposits with Banks	8.1	8.7	4.2	7.8	8.7	6.2	7	9.7	5.9	3.2	9.8	20.1
B. Investments	22	22.9	60.8	58	17.5	21.2	4.6	4.6	11.5	9.6	11.6	7.8
C. Receivables	65.2	64.5	20.9	20.5	71	70.4	82.9	80.2	77.8	81.3	75.1	68.7
(i) Loans and Advances	61.7	60.9	17.2	16.2	69.4	68.8	81.6	74.1	75.6	73.1	62.1	58.8
(ii) Sundry debtors	2.4	2	2.6	3.4	0.4	0.3	0.3	0.5	1.1	1.1	11.5	8.4
D. Inventories	2.4	2.4	11.7	11.5	1.1	1.1	0.3	0.4	2.4	3.7	0.2	0.4
Industrial Securities	1.6	2.3	9.7	11.4	0.3	1	0.3	0.2	2	3.4	0.1	0.3
E. Net Fixed Assets	1.4	1.2	1.5	1	0.8	0.8	4.2	3.8	2.1	2	2.8	2.3
F. Other Assets	0.7	0.2	0.8	1.3	0.9	0.2	0.6	0.9	0	0.2	0.3	0.6
Total	100	100	100	100	100	100	100	100	100	100	100	100

V. Conclusion:

It was observed from the consolidated results of the select 1,211 non-Government financial and investment companies that growth in income, both main as well as other income, decelerated during the year 2008-09. Though, growth in total expenditure also decelerated, it was higher than the income growth. The growth in expenditure was mainly driven by the growth in interest payments. As a result, operating profits of the select companies declined along with diminishing profitability during 2008-09. Business of select non-banking financial and investment companies expanded at a slower pace during 2008-09. The share of external sources in total sources declined during 2008-09 when compared with the previous year. However, they continued to be the major sources of finance. A substantial portion of funds raised during the year was in the form of borrowings. Other significant portion of funds was in the form of raising fresh capital from the capital market. Major portion of the funds raised during the year was deployed as loans and advances in the credit market. However, its share in total uses of funds decreased. The share of 'Investments' in total uses of funds increased during 2008-09 on account of investments in the mutual funds and shares and debentures of other Indian companies.

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